TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING
THURSDAY, MARCH 25, 2004

The Consumer Advisory Council met at the offices of the Board of Governors of the Federal Reserve System, Washington, D.C. at 9:00 a.m., Agnes Bundy Scanlan, Chair, presiding.

Members present:
Agnes Bundy Scanlan, Chair
Mark Pinsky, Vice Chair
Dennis L. Algiere
Janie Barrera
Kenneth B. Bordelon
Susan Bredehoft
Sheila Canavan
Robin Coffey
Anne Diedrick
Dan Dixon
Hattie B. Dorsey
Thomas P. Fitzgibbon
R. Charles Gatson
W. James King
Ruhi Maker
Patricia McCoy
Elsie Meeks
Bruce B. Morgan
Debra Reyes
Benson Roberts
Benjamin Robinson, III
Mary Jane Seebach
Paul J. Springman
Forrest F. Stanley
Lori R. Swanson
Diane Thompson
Hubert Van Tol
Clint Walker

Others present:
Dolores S. Smith, Director, Division of Consumer and Community Affairs
Edward Gramlich, member, Board of Governors
Ben Bernanke, member, Board of Governors
Susan Bies, member, Board of Governors

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9:00 A.M.

CHAIR SCANLAN: Good morning, everyone. My name is Agnes Bundy Scanlan and I'm Chairman of the Federal Reserve's Consumer Advisory Council. Welcome to our first meeting of 2004.

We have a packed agenda. Our first topic that will be discussed is the Community Reinvestment Act. The next topic will be the rules on uniform standards for clear and conspicuous disclosures. Then we'll have a break and then we'll have a discussion on the General Accounting Office's, the GAO's study on predatory lending. After that we will have a presentation from one of our members of the Consumer Advisory Council, the Vice Chair, Mark Pinsky. He will be talking about the National Community Capital Association's FDI transition, industry in transition.

But first I'd like to welcome the new members. We do have several with us today. Dennis Algiere with the Washington Trust Company; Sheila Canavan, with the Law Offices of Sheila Canavan; Anne Deidrick, with J.P. Morgan Chase; Hattie Dorsey with the Atlanta Neighborhood Development Partnership; Bruce Morgan with Valley State Bank; Mary Jane Seebach with Countrywide Financial Corporation; Paul Springman with Equifax; Forrest Stanley with KeyBank; and Lori Swanson with the Office of the Minnesota Attorney General.

I'd also like to welcome our Governors who are here with us this morning. Thank you for being present.

I'd also like to acknowledge Dolores Smith who we feted last evening at dinner, who is retiring after working with the Federal Reserve for over 28 years. Many of those years were spent working directly with the Consumer Advisory Council. Thank you for all the work that you've done with the Fed and the Council.

One important note I want to reiterate is that at one o'clock or as soon as we adjourn this afternoon, we will have a group picture taken right in this room with our Chairman of the Federal Reserve, Alan Greenspan and some of the Governors that are here today and some that will be joining us. So the members of the Federal Reserve, Consumer Advisory Council, please remain in this room.

After we finish our discussion on the CDFI industry we will have committee reports and then after the photograph with the Governors and the Chairman, we'll go into lunch.

And with that, I'd like to start with the topic of the Community Reinvestment Act, and turn to Buzz Roberts for that discussion of issues in connection with the proposed changes of Regulation BB which implements the Community Reinvestment Act.

Buzz?

MR. ROBERTS: Thank you, Agnes. The Federal Reserve Board and other banking regulatory agencies have proposed for comment some changes to the rules regarding the Community Reinvestment Act. The Compliance and Community Reinvestment Committee discussed several of those proposed changes yesterday and just to set the stage for this morning's conversation, they really address the following topics. One would be to increase the threshold between small banks and large banks for purposes of examination. The current threshold is $250 million in assets. The new threshold to be proposed would be $500 million. And that would affect the scope of the examination process.

Second is that affiliates would be responsible for violative or abusive loan activity insofar as that activity would be reflected adversely through the CRA examination process.

Third is to establish that abusive asset based lending, even if legal, would be -- would have an adverse effect on a bank's CRA rating, whether that was taking place through the bank itself or through an affiliate.

In addition to that, there are new disclosure requirements to be proposed with respect to the geographic location of small business and small farm loans. And the Fed has also asked for comment on certain issues relating to the investment test and in particular whether additional considerations should continue to be given to investments that are innovative of complex.

So in order to organize this discussion we will take each topic in turn. We'll start with the small bank/large bank threshold and I wonder if I could ask Hubert Van Tol to begin the discussion.

CHAIR SCANLAN: Can I just remind people to speak right into the mic.

MR. VAN TOL: Thank you, Buzz, for that introduction which I think captures what the issues are. I'd like to speak just first about the raising of the asset level. Small community banks are incredibly important in rural areas. They can be very important for good or ill. Most of the community bankers are really the mainstays of their community and build that community up and God bless the child who has a banker like that. But there are others who aren't quite like that.

The Fed in proposing this change has, I think, not really looked at what the effect would be on rural communities. In the prologue or in the PR related to this, there's been a discussion about how it just simply shifts over a small percentage of overall assets, but if you look in specific states, specific areas of the country, the shift will be much larger and this will have an effect because those communities will no longer have access to banks which are required to meet an investment test and a service test.

In Wisconsin, for instance, there are now 59 banks which are larger than $250 million in assets. Thirty-six of those 59 are in the range between $250 million and $500 million. In Iowa, there are 40 banks that I think that are larger than $250 million that have branches in the state and 22 of those in that $250 to $500 million range. What that means in Iowa is that you have 18 counties that don't have a bank that is tested for the service test or the investment test with locations in their county. The change will mean there's 27 out of the 99 counties that have that. So to simply say that it's a movement of two or three percent of the assets, I think, misses some of the real effect that this is going to have in rural areas.

Rural areas are struggling with developing the infrastructure for community development. We talked about that at our October meeting, the trouble that community development organizations are having as the federal budget deficit looms and the cutbacks in the agricultural department budget loom for us. I think there's going to be even more trouble in terms of funding those kind of activities from the federal government's point of view. So encouraging the small, medium size bankers in our communities to really invest in community development issues, I think is a very important role for the Reserve to take. And I hope you'll -- I suggested to the staff yesterday that you do a study of the geographies out there which don't have access to a bank that undergoes the large bank test and I think if you do that, you'll see where the significant holds are in rural America.

GOVERNOR GRAMLICH: Could I ask a question, Hubert?

We'd like good data on exactly what happens as a result of the investment test and the service test. Is this -- I mean can you provide hard information about how community development really will suffer from this or is this just -- are these just words?

MR. VAN TOL: I think you could develop a data set that shows the difference between the bank that gets an outstanding or a high satisfactory rating on its investment, on the investment part of its test, if it's a large bank and those that get a low, satisfactory or needs to improve. If you can get some data that would show the dollar amount of investment in those communities, whether -- I mean how do you exactly quantify whether -- what good those investments do. That's a job for somebody with more skills than I have.

GOVERNOR GRAMLICH: Of course, that would be hard. But do banks, I mean apart from how effective the investments are, do banks in that range in those rural communities facing the investment test, do they actually put the money into community development activities in the community?

MR. VAN TOL: Some do and some don't. That's what you gauge by looking at in the large bank performance evaluation. Each of the tests is graded. So most banks would get a satisfactory or a low satisfactory on their lending, but there are wide ranges of grades that they get on the investment test and the service test.

I think you can definitely see the difference between a bank that's rated needs to improve on its investment test and one that's rated outstanding in terms of the dollar amounts.

MR. ROBERTS: Debra, did you want to address this particular point Governor Gramlich is raising?

MS. REYES: Well, not directly, but it does tie into his question. But I would see if there are others who would like to address it directly first.

If not, then I will talk about my concern about the increase in the limit. It has to do with community development impact. And it isn't only tied to the investment and service test, but also to community development lending. When we increase this range, then the banks are really basically going to be evaluated on their lending. There are ways you can achieve your lending test credit without really impacting the community development lending. And I have tremendous concern about that. And while I note that community development lending even for the small bank will help move that rating maybe from a satisfactory to a high satisfactory or even to an outstanding, in my relationship with 95 different banks who are members of the lending consortium that I operate, a lot of motivation for outstanding is not there. Satisfactory, yes.

And in addition to that, I would say that the community development impact through the lack of the investment test and the service test are also at issue. Can I measure that specifically. No, but I do believe that the work that does real -- the real hard work, making community and neighborhood improvement comes through community development lending and some of it through the investment test. And I know there are ways we meet the investment test without doing that real hard level community investment, but I think when we look at some of the banks represented in this room, I think that they really are through their investment strategies reaching that and in just looking at the lending consortium that operate with 95 members, about 35 percent of my members will go into the small bank category from this change only. And I don't know what that will mean as far as their membership and their participation in our programs, but I do think we could certainly say that banks that aren't challenged to do that community development lending may find ways to meet the lending tests through mortgage lending which they're already doing and through small business lending that they're already doing, rather than trying to make that real significant community development impact.

MR. ROBERTS: Pat?

MS. McCOY: Just two brief points. The first to echo Hubert. I seem to recall that at the time of the debates over Gram Leach Bliley and the introduction of the small bank concept that there was a pronounced geographic disparity where essentially the great swath of the Midwest starting with the Dakotas and going down to Texas were adversely affected by this change.

And again, I have that same concern now. So I do think it's very, very important not only to understand the impact on rural America, but what that means for actually removing the operation from CRA in whole swaths, geographic swaths of the country. As for the request for data, I normally would prefer to do the studies first and then contemplate a change, rather than make the change in the absence of data.

MR. ROBERTS: Dan.

MR. DIXON: Just one comment and I'll use the classic analogy of the carrot and the stick. I'm not sure that this focus on the regulatory pressure to encourage community development and community investment is going to ever be as effective as developing the programs which are attractive to the folks that have the money. And I think it's safe to say that bankers are probably cleaver enough to find ways to meet regulatory objectives that aren't going to 100 percent match the interest of a specific community development operation in a specific market if they don't want to do that deal. But if the deals that are available are attractive enough, you don't need regulations to get interest.

MR. ROBERTS: Tommy.

MR. FITZGIBBON: Hubert, I think your argument is very, very strong and compelling in terms of the rural, of the potential rural impact. I think it's important for us to take a look at that. But I think there's also an impact from an urban perspective. And the change, and I have looked at the numbers to tell what would happen in Chicago, but in looking at the sort of paradigm shift in banking urban-wise, where what we've got and I think Illinois for the last three years has led the nation in de novo charters. As all of the banks get bought out and all the old officers end up with change in their pockets and start new charters, what we're seeing, in effect, is where shops that are growing to fill a void in that $100 million to as high as half a billion dollars, frankly, are coming in and competing in markets that -- it's important -- competition is important in terms of serving a consumer. But in essence, if what we do is we say okay, you don't have to do anything in terms of investment or service, you need to just do lending. What it does in the urban market is -- it does not allow for the opportunity for sharing intelligence on how community development investment lending is done in urban markets.

Like several of us around here, I participate in many consortia types of efforts to deal with small business lending and mortgage lending and other types of entities. Without that other partner, the smaller institution, where intelligence can be shared so that they can actively participate in dealing with markets that can only be understood by virtue of their participation and investment opportunities generally through third parties, generally through nonprofit organizations, although it doesn't have to be and to exempt them from this, I think, does a disservice to the potential capital needs in urban communities.

And last, but not least, if you will, is that we all talk about level playing field. We happen to -- our shop happens to, by virtue of some changes in the industry, ended up to be either the number two or number three Chicago-based bank. Don't ask me how it happened. It just sort of happened while we were away for the weekend.

(Laughter.)

You know, shops that can leapfrog into our market from the suburban communities and can, in effect, suck deposits out of our market and not really have sort of the same kind of evaluation, really I think is a bit unfair.

MR. ROBERTS: I would just add with respect to the rural issue that already CRA exams on very large banks have a hard time capturing their activity in rural areas because the examinations tend to focus on the major metropolitan areas where those banks are operating. Rural areas are really by definition very dispersed and so the exam process does not focus much on the rural activities of the very large banks.

So if you're sitting there in a rural area and there's not a lot of CRA scrutiny on the very large banks that are serving your area, and now there's not going to be very much scrutiny for CRA purposes on not just the smallest banks, but many of the bread and butter banks between $250 million and $500 million, it sort of leaves you wondering where you turn to for CRA's engagement in your rural community.

Susan.

MS. BREDEHOFT: Yesterday, we discussed the fact that maybe some banks aren't prepared for achieving the threshold, of crossing that threshold to becoming a large bank. And since they haven't really participated in investment or service opportunities, they may not know where to go to do these things. I'm from New Jersey and we have a variety of opportunities available, yet a bank in that middle category recently failed their CRA exam because they did not have any service test activities. They did have investment tests, but they didn't have lending activities either.

Maybe what could happen is if the regulators in the local areas could identify those banks who are about to reach the threshold and set up a conference consisting of large banks, small banks, nonprofits in the area to discuss opportunities and that the larger banks could welcome these banks sort of into the fold, you know, we may have inadvertently created some sort of a clique in my state. It's the same banks who participate, the same banks who invest, the same banks who get the publicity.

So maybe as large banks, we could coach the smaller banks and help them successfully cross over that threshold.

MR. ROBERTS: Tommy.

MR. FITZGIBBON: I was just going to echo your remark. And that's exactly what's happening in Chicago. Robin can tell you, I can share with you those that unfortunately they approach us at the last hour. We went through the $250 million ceiling two years ago and now we have to find out what we need to do.

So I think that there's some sort of lack of understanding of what this threshold means, whether it's $250 or $500. I think we'll have the same issue in terms of the delaying the process of understanding what it means to do and to provide community development service and to find, look for and find and invest in community development opportunities.

MR. ROBERTS: Bruce and then Hubert.

MR. MORGAN: As a small bank on this Council, I think the threshold of $500 is really too low. I think it should be $1 billion because what we're talking about is streamlining the exam procedure for the smaller banks. I think if we want to stimulate rural development, community development or economic development, then I think the approach should be to find the incentives.

The Federal Reserve Board of Kansas City through their Community Affairs Department put together with the Federal Home Loan Banks a great program called Doing the Undoable Deals where we try to identify where are there gaps in providing housing in urban communities, suburban communities, rural communities and then the Federal Reserve Board facilitated a series of workshops in those various areas and actually put the bankers together with the various resources to kind of stimulate those things.

Now the Federal Home Loan Bank of Topeka, we've got a number of affordable housing projects and community development projects funded out of our 10 percent that's set aside twice a year. And I think rather than put the additional regulatory burden and there is burden in the full CRA exam process on a small bank and that burden diverts the bank's attention, capital and staff away from actually being engaged in their communities.

So if anything, I would argue that $500 is great, $1 billion would be better and that rather than focus on a punitive approach, we need to be looking at where there are incentives and what kinds of things can we do through the Federal Reserve and the community affairs part of the Federal Reserve to really stimulate more of the kind of activity that we're trying to encourage in those local communities.

We recently met with representatives of the Center for Rural America which is based in Kansas City's Fed and really we're trying to challenge them to put together a program on rural entrepreneurship because we really think that's where the focus ought to be rather than the excessive examination burden.

MR. ROBERTS: Hubert? Governor Bernanke, did you have a question?

GOVERNOR BERNANKE: I did have a question, yes. And I think it relates to Governor Gramlich's question. Another way of thinking about this, we're not certainly proposing to relieve banks of any size of the CRA obligation. The question is what is the structure of the examination of the obligations?

One way to think about this and I'd be interested to just get a reaction is that the three part test is something of a strait jacket. It requires certain types of activities to meet the obligation. You could imagine a rural community, for example, where there's more opportunities for lending than there are for investment, let's say. Or you could imagine a small bank that has an expertise that allows it to be very effective in providing the services, but not in some other category.

So I guess what my question is -- is there a way to maintain the effectiveness of the program, but allow more flexibility in terms of matching the particular expertise or strengths of the financial institutions and the needs of the communities without -- this is just a question and it's most relevant in the rural areas and small banks. That doesn't necessarily fit the three part test. That's just another way of thinking about this question.

MR. ROBERTS: Hubert?

MR. VAN TOL: Yes, I think that is an important question. I've read a fair number of small bank and small/large bank performance evaluations over the years and it seems to me that there is already a fair deal of flexibility built in -- in a number of ways. In the performance context, there's usually what the examiner looks at in terms of what they rely on to make their ratings and in that performance context they often talk about issues of what the shape of the community is and whether there are many avenues for investments for the larger banks.

But I guess one of the issues I do want to address as well is it's important for the flexibility not to be taken too far because there are often cases of banks with almost no investments at all, in effect, given a pass by the examiners because of the performance context, and I think those, are kind of chicken and egg issues, sometimes. I agree with Bruce that we do need all of the positive incentives. We do need the Federal Reserve staff trying to -- in the regions, trying to bring people together to develop skills.

But in rural areas where you have difficulty with the community development infrastructure, in the first place, I think there has to be some of these -- they're referred to as punitive incentives to get some institutions to seriously consider the issues. One of the regulators, not the Federal Reserve, goes to great lengths to provide small banks with a number of ways to, I would say, avoid the large bank requirements because we already with Gram Leach Bliley, we already have these four and five-year terms between exams and then often when people pass it, the definition of a small bank or a large bank is one who has been at that asset level for two December, 31’s in a row, so they already have this full year that they should be thinking about these issues. And it often seems like on the first exam after they then pass, they're still really treated as though they were a small bank. I think there has to be a little more discipline enforced on making people start thinking about services and investments when you reach a certain size.

MR. ROBERTS: I have Robin and Mark and then I think we need to move on to the next part of the proposed rule.

MS. COFFEY: I think what your question dealt with is on the regulatory burden that people seem to talk about is where do you draw the line in the sand? Right now, it's $250 million. If you make it $500 million, yes, more banks will be exempt, but you'll still have the same issues where when they get close to that $500 million or they cross that line, they're going to have the same regulatory issues that they currently have at $250. So you're not increasing -- at some point in time a bank grows to a certain size where the regulatory burden will increase. It's going to happen. And what we're trying to decide, I guess, with this conversation is what's the asset size of that bank before it happens?

Eventually, it's going to happen. $250, $500, $1 billion, $2 billion, eventually, you're going to have the regulatory burden of everything else that goes along with having a bank in addition with complying with CRA.

MR. ROBERTS: Mark?

VICE CHAIR PINSKY: I think Governor Bernanke, I think it's a really interesting question to ask because I think -- I may be mistaken about this, but I think at least some banks, if not all banks have the option of preparing a strategic plan or a business plan and having some, creating some flexibility that way. I'm not sure I know the rules exactly. And I think that raises an interesting set of questions. From my experience in the banks that I deal with, I think that that's not a widely -- not that many banks choose to do that.

And I think one of the reasons they choose not to do that is the notion of that is to look at a market, but to look at a market that's perhaps unconventional for what the bank usually serves. It's a little bit outside of the margins in what they might otherwise do and so, in effect, what you might do is you might find a need to change what you do, not to be sort of locked into that structure, perhaps, but it may mean you're offering products -- there's a reason you're not offering the products. If you thought those products were good products for you, you'd be offering them already, right? So it means maybe changing your underwriting criteria or changing the products you offer and things like that.

And so I think that's one of the reasons that more banks haven't taken that option, but I think it can be a good thing, while regulated, well, overseen I guess is a better word, to ensure that, in fact, what you're really doing is serving the needs of those markets or those populations or those people or those communities that are outside of what the bank already does. And so I think there can be some good out of that. But I think there's a discussion about the process and how you think about those questions and whether, in fact, that flexibility makes it almost harder for the bank to do some of those things.

The flip side of that is it raises the question about if the way a banks meets CRA undersell lending test or investment test is to do more of what it's already doing, the question is are they really able to reach all of the people that they're trying to reach in the market, outside the margins?

MR. ROBERTS: We will take Dennis and then move to the next topic.

MR. ALGIERE: Very briefly. I just wanted to answer part of the question, was if this proposal were to go forward, in my opinion certainly wouldn't relieve any bank, small or large, from having to comply with CRA.

MR. ROBERTS: Okay, the next part of the proposal deals with abusive asset-based lending activities. The proposal is that even where these activities are legal, lending solely on the basis of the foreclosure value of a property will be considered adversely with respect to CRA.

Who would like to open up this discussion? I see Pat.

MS. McCOY: Thank you. I'm quite concerned that this proposal is limited to one abusive practice, asset-based lending which indeed is very, very serious, posing harm both to the consumer and safety and soundness concerns for any institutions engaging in it.

But are concerns about other practices that this rule does not address that I would like to see receive demerits if this type of lending is being performed by an institution. Then the question would be, well, how do we identify other practices that should be discouraged?

And my proposal would be this. First, we need to define which loans we would be looking at and the loans that I would propose to look at would be subprime home mortgages for which there now has to be reporting under the 3 point spread for HMDA. So any subprime home mortgage that had an interest rate higher than 3 points above the Treasury benchmark would be scrutinized.

Then the other part is what would they be scrutinized for? And for this, I think we have a very obvious list of practices we can go to which are the practices currently prescribed by

HOEPA, both by the statute and under the Fed's regulations, but to look at that larger group of subprime loans for any such practices. This is a set of practices for which we've had substantial public comment and input and I think it's fair to say that there's a consensus that these practices are injurious on balance to consumers. So I would expand the list of prescribed practices to that list.

GOVERNOR GRAMLICH: Buzz, the way you're taking it up makes it look like those practices are not proscribed, but in fact, it is illegal, any illegal practice -- so if some practice is illegal under HOEPA it would fall under this stricture already.

MS. McCOY: The one difference, Governor Gramlich, is that the practices that HOEPA identifies as problematic I would also examine another set of subprime loans for the same practices. And those would be subprime loans that are above the 3 point trigger, but below the HOEPA triggers.

GOVERNOR GRAMLICH: Okay, so you would have the examiners, in effect, expand HOEPA?

MS. McCOY: Only for purposes of granting a favorable CRA exam rating, only for that purpose. So I'm reasoning by analogy.

MR. ROBERTS: What kinds of practices do you have in mind that you would consider abusive even though perhaps legal?

MS. McCOY: Currently, for example, if we're only looking at federal regulation for subprime home mortgages that do not -- that fall below the HOEPA triggers, there's no regulation of the balloon clauses. There's no regulation of the duration of prepayment penalties.

And we can look at other things that are prescribed for loans that go above the HOEPA triggers, but not below.

MR. ROBERTS: Who else has a comment on this issue? Yes.

MS. CANAVAN: Sheila Canavan. I would also be interested in working on the -- how the process of the examination is done because I don't think it's always easy to detect abusive lending using traditional measures that have perhaps, such as looking at LTVs and so forth. I think we need to develop new techniques and I'd be willing to work on that and I think many consumer representatives would provide input. I think that we need to look at different things such as the advertising that's done for the consumer, that perhaps training manuals for employees, for example, some things that will send up a red flag that perhaps is more to the story here than appears.

I would like to add to what Pat said. I think that we should look at things such as a high cost loan unrelated to the risk of the loan. You see all these fees and you say well, why is that borrower with a 750 FICO score being charged these fees? It's just -- it will give a much fuller picture of what's going on.

MR. ROBERTS: Hubert.

MR. VAN TOL: I think one of the problems with how the agencies have framed this issue, perhaps relates to highlighting the problem of asset-based lending because I think the fear among community groups is that, that then becomes sort of the standard for what predatory lending is in the country. To use an unfair analogy, the agencies wouldn't define bank robbery as being primarily the relief of money from a banking institution with automatic weapons. That's certainly one type of bank robbery. But once you highlight a definition that appears to many consumer groups to be almost the least of the problems that at this point, because what we have in communities is we have banks living up to the law, they're tucking their fees and their rates right under HOEPA and they're sucking equity out of homes. They're not necessarily doing it to force the home into foreclosure. But most of us from the community side view that as being predatory lending. And how you get at preventing that, it seems to me that the way to get at preventing it is we have to have some limit on the amount of fees and points that can be financed because when you have a high cost loan and people can throw those fees and points back into the loan, that's the essence of how equity stripping works.

GOVERNOR GRAMLICH: Let me -- when you comment on this issue, as Buzz pointed out, this is one case where the proposal debits I guess affiliates of banks for practices that are legal. And so I think the issue is would you not have us do that at all and just stick strictly to illegal practices because I mean there is an issue here if you start debiting for some legal practices, should you debit for more illegal practices, as many of you are suggesting.

And you know, we could be getting on a slippery slope. So maybe what many of you are saying is just stick to things that are already illegal, but I just would like to hear if that is what you're saying or if you would have us expand the domain or contract the domain?

MR. VAN TOL: That is not what I am saying. I think the overall concept of debiting is a good concept. I think you just have to be careful about how you -- that you don't give primary emphasis to asset-base lending as being the de facto definition of what predatory lending is.

MR. ROBERTS: I have Agnes and then Ruhi and then Pat.

CHAIR SCANLAN: Actually, mine is a question for Sheila and to go to the illegal practices, but you mentioned that there should be more of an examination of training materials. I know for a fact that training materials are examined during the course of a CRA examination.

Are there any other specific practices that you would suggest that do get examined to go to the illegal aspect of this activity to be examined during the CRA exams?

MS. CANAVAN: Well, first of all, with regard to illegal practices, in a deregulated era, very few practices are illegal, at least in mortgage lending as I view it. So I don't think we're going to get very far if the examination is limited to looking for illegal activity.

CHAIR SCANLAN: Well, you had mentioned that training is one thing that should be examined and it already is at least from our standpoint. Are there any other examples that you might also offer, that might get to the heart of the issue?

MS. CANAVAN: Age of the borrowers. What kind of loans people are receiving? Are they getting an adjustable rate mortgage when they're living on a fixed income? Are they getting a 30-year loan when they're going to die in a couple of years? There are actually a lot of things that may not be things that are looked at in the examination process now, but since I'm not very well educated on what is looked at --

CHAIR SCANLAN: In my opinion, all of that is looked at.

MS. CANAVAN: I think this is a very rich issue and what I'm raising today is really to be given the opportunity to work with the examiners and developing a larger protocol for examination process.

MR. ROBERTS: Ruhi.

MS. MAKER: If I could elaborate on that a little bit more, I think what we're trying to say is that right now you're a bank and you do quote unquote due diligence and you look at the papers and you see whether or not you're doing predatory lending or not. And what we have increasingly said to the banks is that you need to go beyond the papers. And like Sheila said, many of the consumer lawyers are happy to work with the Fed and other agencies to develop protocols where you actually look at the loan level data and you look at the loan and it will involve actually going back to the borrower and looking for things like all right, the HUD one says X was paid off and you go back and you say well, X was a loan with a prime lender of 7 percent and it was paid off with a 14 percent loan. Now that is, in fact, a UDAP, potentially a UDAP, a Deceptive Practices Act violation, but it's not something that can be captured by just looking at the papers. You go and you say the interest rate cards were paid off and you see all those cards that were paid off were actually at a lower interest rate than the new interest rate of the new loan. And what you've got -- we have seen so many of these kinds of loans now that you essentially see a prime loan paid off at 14 percent. Credit cards which are unsecured at 11 and 12 percent paid off at 14 or 18 or higher interest rates and you paid 8 percent or just below the HOEPA guide, beg your pardon, it's always 7.99 in points and fees. And those are the kinds of practices that where you go beyond the papers and we sort of get into this impossible how can you do due diligence and we have a vehicle. We capture these very unsophisticated clients. They come in. We use college interns to interview and within an hour or less we very quickly figured out what are the kinds of violations that have occurred which we then, of course, represent those folks through litigation. Well, what we're suggesting is that you go back, you look at the papers, you do some sampling. Obviously, there's no question that you look at everything and Pat's point of looking at loans which are 3 percent above the trigger, that will be captured in HMDA. You look for folks where you have people living in minority census tracks who are of color. Those are prime candidates. Anyone who is a consumer lawyer will tell you that. People of color, women of color, very high probability who sample some of those loans and you look for some of those kinds of practices and I think the fact that the Fed is going to go do that as part of CRA exam of loans that originated and loans that are securitized because that's where some of these abuses occur, will I think go a long way short of -- I mean I think I hear one of us, some of our frustration is we're trying to legislate through the Fed and we know we can't do that and I think Governor Gramlich that's what we're saying. You obviously can't do that. Given that there isn't federal law, but that you have some power through CRA, what are the kinds of tools you can use and I think we will certainly work with the Fed and come up with solutions to look at those kinds of levels of detail. And I think that's -- I hope is what I would sum up, trying to get at here. I hope that's helpful.

GOVERNOR GRAMLICH: Yes, I think I understood you, but I think -- I just want to make clear what we're talking about. Are the bankers in the group excited about, through the CRA tests, significantly improving consumer compliance laws? I just want to get that out there, if that's what you're telling us to do, we'll listen. But I just want to make sure that's the way we're -- if we're hearing you right.

MR. ROBERTS: Does somebody want to respond directly to Governor Gramlich, because we've got several people already lined up to speak?

Dan, do you want to jump in on that?

MR. DIXON: I would just say the vast majority of the institutions that the bank regulators examine are just as interested as some of our consumer advocate friends in dealing with true predatory lending. It fouls the water for all of us. It disrupts neighborhoods. In many cases, it's our prime loan that got refinanced, flipped.

Having said that the answer is not a dramatic increase in the regulatory burden that is applied to all institutions. It's got to be focused on the institutions by whatever name they may go, whether it's bank or mortgage company or whatever. It's got to be focused truly on the abusers because otherwise you're adding cost and interfering with those of us that are trying to do the right thing.

MR. ROBERTS: Okay. I have Pat, Diane and Tommy.

MS. McCOY: I think it's important to remember that the flip side of giving demerits for certain types of lending practices is that the institution essentially receives approval or a positive exam rating if this is not scrutinized. And this then confers benefits on the institution in terms of reputation, in terms of applications processing, etcetera.

So it's very important for the Federal Government not to put a thumb on the positive side of the scale if there are highly problematic practices. I don't think the test should be -- is the practice currently illegal under federal statute. We need to be concerned about other practices that right now are not forbidden by federal statute. But that have proven to be highly injurious to consumers.

And we also need to find out a way of identifying those practices for which there is largely consensus support that the problems are problematic. I think the way we do that is to take the HOEPA prohibited practices and exam this larger group of subprime loans for those same practices. There's been substantial public input on that list of practices.

GOVERNOR GRAMLICH: I don't mean to be a nag on this issue, but is that for us to do or is that for the Congress to do?

MS. McCOY: I think it's well within the Board's discretion to do that. And I'm particularly concerned because again, CRA has the effect of conferring benefits on institutions if they get the two highest exam ratings and I'm concerned about that happening where we have a longer list of practices that I'm very worried about.

MR. ROBERTS: Okay, I have Diane, Tommy, Forrest and then we're going to move on to the next topic.

MS. THOMPSON: I think my concern is close to Pat's which is that the Community Reinvestment Act which is what we're talking about here is designed to make sure that banks are investing money in the communities from which they're taking money. And predatory lending and abusive lending is an example of the reverse of that, sucking the money out of poor communities.

And what I don't want to see happen and why I'm concerned particularly about just looking at asset-based lending is I don't want to see banks getting CRA credit for bad, abusive lending that subverts the purpose of the act. It undermines the efforts of community groups who do good work and it makes to me no sense that you can have two banks, one of which is struggling to meet the investment test and the lending test an the services test with products that are appropriate and designed and work to do the undoable deals and get the credit for those. Then you can have another bank that, in essence, is making bad loans and it has an easier time making the bad loans because it's not worrying about it and it's going to get better CRA credit because we're not going to look at what the net effect of those products is? We have to look at the full range, whether or not this is a good loan or not. If you're going to give someone CRA credit for it. I think that's my concern.

And I think Pat's is a good starting point, but I would build on Hubert's. Exams happen. You have to look at the full range of abusive practices and banks should absolutely get demerits if they're engaging in abusive practices that strip equity from communities.

GOVERNOR GRAMLICH: Could I ask about that too? How would you characterize the present law? Do you think the present law is better in the way that you're saying?

Present regulation.

MS. THOMPSON: No. I think that in the present regulation, my concern is that there is not necessarily, that examiners are not necessarily empowered to look aggressively at the abusive practices that banks' loans may be engaging in, but I think that there is a sense that if it's legal that is the test, not whether or not was this a good loan for the consumer and in the end, that ought to be part of what we look at when we examine.

GOVERNOR GRAMLICH: What I'm trying to get at is -- is the draft proposal a step in the right direction from your point of view? Because it has --it arguably tries to clarify that these type of practices are -- should be debited and what many of you are saying is you ought to have a longer list and I hear you. Maybe we should, but the question I'm raising is -- is it better to start on the list or not to start on the list?

MS. THOMPSON: Absolutely, it's better to start on the list, even with the limitations that you've identified. I think it would be better to have a broader test, but I think it is better, I will take baby steps.

MR. ROBERTS: One of the issues is how long it takes to have the opportunity to take the next step and if it's going to be five or seven years before there's another CRA rule, that's an awfully long time and the way this rule is proposed, it makes it clear that the only abusive practice that will be considered in this way is asset-based lending. And it does not even open the door to less formal policy decisions by the regulators at other abusive practices at any point prior to the next full rule making.

GOVERNOR GRAMLICH: You can, you are probably better lawyers than I am, but there is some language in there that permits states to broaden the list, right? So it's not set in stone for seven years or whatever length of time before we revisit this.

MR. ROBERTS: Let's see if we can wrap up this portion. We've got Tommy and Forrest and Hubert, if you're dying to get in here, I'll let you in.

CHAIR SCANLAN: And Buzz, you should know you have a little bit more time if you need.

MR. ROBERTS: Okay, thank you.

MR. STANLEY: Just getting back to the proposal, we've seem to have crept into a whole other area. I think that almost the entire financial services institutions that are regulated have absolutely no objection to a debit for asset-based lending.

I don't know that there's ever been any evidence that a regulated institution has engaged in asset-based lending. I know it is prevalent in the community. I would say it's not prevalent in banks that are regulated by the Fed, the OCC and the OTS.

I mean it's just Banking 101 to look at the credit of the borrower. But to try to expand that list, we can debate from here to next week what is a valid subprime practice and what is a valid -- or a predatory practice. I am very concerned not only about number one, trying to expand the list to things that we may very much disagree on, but more importantly to Ruhi's comment, to try to come up with some subjective standard that alone -- when you're paying off credit cards and paying off a loan, it's kind of this benefit for the borrower test. We just had a discussion yesterday in one of the committees about was it better for a borrower to have an ARM loan versus a fixed loan? There are people that will say and I believe Sheila said before that she objected to an elderly person getting an ARM loan.

I don't know. I'm a banker. I don't know that that's a bad practice and I think a lot of people could argue that that's a valid product if that's what that person wants.

So I'm just trying to caution against mission creep here. I think the industry has no problem with the asset-based debit because we don't do it and we shouldn't do it. It's just not good practice. And as I said, it's banking 101.

MR. ROBERTS: Tommy.

MR. FITZGIBBON: I just wanted to frame the debate a little bit, if we can, because I think we may have missed that in the opening part of that. This is purely to deal with whether or not an affiliate making loans and having those loans count be credited to the institution would then have to meet this scrutiny, as well as the bank's own originations, but the key to this, I think, is really looking at whether or not those affiliates behave in the same way, shape, fashion or form as regulated banking institutions and I can tell you from first hand, they don't and so the key to this debate is the community has been saying for a long, long time that if these affiliates are generating credits that just stink, they shouldn't be given credit for these in terms of serving low, moderate income markets in the community and that makes all the sense in the world.

And I think that that's an appropriate way for us to begin the process by starting with at least an initial step, a baby step, if you will, of identifying what shouldn't be done.

The second, when it comes to policies, procedures and practices, I can tell you having worked in this industry for as long as I have is that they have their own set of rules and they generally don't even behave by those, much less what the bank does. So I think this might be a real good opportunity for us to begin to develop some standards in these mortgage banking affiliates of regulated financial institutions and maybe that will set the standard for the rest of the industry.

And last, but not least is sort of looking at beyond the definition of what's legal and illegal, if you look at the, and I try to remember the citation, but it was a DOJ California former thrift that became a mortgage company. I can't remember off the top of my mind what the settlement was.

MS. MAKER: Long Beach?

MR. FITZGIBBON: Long Beach which was -- basically had nothing to do with predatory practices, but it was charging minority applicants more for the same basic credit criterion as nonminority applicants and I think that's some of what I think we're likely to see when we start getting into evaluating the mortgage affiliates of charter depository institutions.

MR. ROBERTS: Hubert.

MR. VAN TOL: I know time is pressing, so I will pass.

MR. ROBERTS: There is a second related provision in the proposal that would specifically speak to affiliates and say that any of the affiliate activities that were violative or abusive would adversely affect the CRA rating of the bank, but only for those affiliated activities that were occurring within the assessment area of the bank.

MS. DIEDRICK: Buzz, I'd like to speak to that?

MR. ROBERTS: Yes.

MS. DIEDRICK: And here I am not responding to the abusive asset-based lending practice, but rather to the general compliance issue with the fair lending laws that go on in the bank.

Currently, unlawful discrimination or other unlawful credit practices found in the course of a bank's fair lending examination may lead to a downgrade in the bank's CRA rating and I think that's always been the case, as far as I remember from 25 years.

This proposal would extend that concept to include a downgrade in the bank's CRA rating should it use the loans of an affiliate that has been found to have violations of one or more of the fair lending laws, usually during the course of an examination.

I applaud the spirit of this proposal, but it creates an uneven playing field between banks who include loans, generally, mortgages, from an examined affiliate versus banks who include mortgages from unexamined affiliates. Banks with affiliates that undergo regular and rigorous fair lending compliance examinations should not be penalized for having a more rigorous compliance and examination schematic, nor should they have a higher threshold for achieving a passing CRA rating than their peer banks.

MR. ROBERTS: Anybody else want to address that issue?

Yes, Susan.

MS. BREDEHOFT: There are a couple of comments I'd like to make. I think Tommy made a good point about fair lending analysis and comparative file analysis which is being conducted today. How is one applicant treated, what type of loan did they get as compared to a similar applicant's. Are they paying higher rates? Are they paying higher fees? Everything should be equal based on similar credit history, similar products requested, similar situation and that analysis does occur today and perhaps adding that type of analysis when affiliate loans are brought in, that could be a good way of addressing the situation.

On products, I know New Jersey instituted a predatory lending law and they say if a borrower wants to refinance, you have to prove in that tangible benefit. Well, what does that constitute? Right now, rates are low. Suppose when I retire I want to refinance my home to travel and rates are higher and I'm going to spread that payment over 30 years. Obviously, that may not be the best financial decision, but it's what I want to do. And will -- banks are saying well, how are we going to serve customers who want to do that? There really is no net tangible benefit and somebody may look at it that I'm really squandering the equity in my home to travel and paying an higher interest rate and spreading that payment over 30 years.

The other thing, what about -- I'll call them nonregulated mortgage companies. And technically, they are regulated, but nobody really examines them. I know the FTC has the authority to do that, but I don't think that they do. That's where I think that a lot of abuses occur, so talking about a level playing field, I think that we really need to consider what we're going to do about those mortgage companies.

MR. ROBERTS: Ruhi.

MS. MAKER: Susan, if I can address your point, there are some clear bright lines. I agree there are circumstances when you go to an ARM, but there are certain clearly bright lines, when you take $80,000 in secured debt; $20,000 in unsecured debt, get no cash out and raise your interest rate in both those loans and go from an unsecured rate to a secured rate. To me, it should be fairly -- I don't see how anyone could argue and I know it sounds nuts, but we've seen many, many clients like that where you take your $80,000 secured loan which goes from 7 to 14 and you unsecure that. You get no cash out. Your monthly payments goes up and your cost of credit goes up and the term doesn't change. I think those are the kinds of things that if we would have some loan level analysis of, I would hope that all of us can agree on that that's the kind of thing that does occur and that you should be able to do low-level analysis and downgrade an institution for that and I'm assuming that everyone around this table is going to agree to those kinds of net tangible benefit test analysis that we're trying to talk about, I think if we can at least agree on some minimal baby steps, as Diane said.

MS. BREDEHOFT: I just want to respond to that and I agree. I'm just saying be careful. We need to be careful how we say things. We need to be careful how we define things.

MR. ROBERTS: Benjamin.

MR. ROBINSON: The one thing I would add is we talk about this and we can debate this for a long time is that we also consider educating the consumer. One piece that I don't hear us saying is how do we help the consumer to be more informed as they decide these types of things and that's the party I don't hear us talk about enough at these forums.

MR. ROBERTS: Go ahead, Hubert.

MR. VAN TOL: One of the things I don't think that we did talk about yet is the rule asks about considering these things outside of the assessment area and outside of the bank's assessment area for lending. And I think that is an important issue for you to think through because it has particular importance for rural areas. We have now the largest banks in the country's subprime affiliates are moving increasingly into rural areas and we're getting those daily, monthly offers of get $5,000 quick, easy for 19 percent and those are the kind of loan offers that then get flipped over into mortgages that we're getting from major banks that are regulated by you in rural areas. They don't have a presence where they are providing us with prime product. When I got one of those offers recently I tried to refinance my home and it was -- took several days for them to get back and the offer they had clearly wasn't anywhere close to what I could get from a local institution. So I think there's that kind of skewing with huge banks that have enormous marketing power hitting rural communities with bad products and not providing good products. So I think that should be looked at as part of the CRA review.

The other part that this doesn't touch on at all that we have to remain aware of is the whole issue of buying, servicing and securitizing those types of loans. That's not mentioned in the regulation. That is probably the place where the largest banks in the country have the most effect on abusive lending. If they have good standards for scrutinizing those loans as they're deciding whether to securitize them or not, won't make a lot of difference than if they have no standards at all.

MR. ROBERTS: Agnes, how much time would you allow us?

CHAIR SCANLAN: You have got about 10 more minutes or so.

MR. ROBERTS: Let's take Diane and Pat and does anybody else want to get on this one and then we'll move on. Tommy, we'll also get you.

MS. THOMPSON: To build on Hubert's point. In the report that the Joint Center for Housing Studies at Harvard released in early March, there are some very, to me, interesting and suggestive data that indicates that lending institutions make much better loans in their assessment areas than they do outside of their assessment areas and that, to me, is very strong support for the proposed regulation, that what it shows is that CRA has, in fact, had a beneficial effect, that it has increased, it has encouraged banks to make good prime loans which foreclose at a much lower rate.

And so that if we want to expand that effect, it seems to me very natural and logical that we look at the loans that are made by the same institution outside of their assessment area.

Benjamin, I think we do sometimes talk about financial education and we talk about how to make the disclosures meaningful. I think that perhaps some of the reasons we don't always talk about in predatory lending is that many of us around this table spend a lot of time trying to help educate consumers about it and are somewhat jaded as to whether or not this is a process that you can actually effectively educate consumers no matter the quality of your education and I think that concern is borne out by the GAO report.

Although I think we all agree that financial education is important and that it's a part of the puzzle, but you can't stop there. And my concern is always when people talk about financial education, we're going to do that piece, because it's a piece we can all agree on, but not do the piece that is harder and that must be done.

The conversation about the level playing field concerns me. When we start talking about a level playing field between banks that receive good exams and good regulation and are doing good work, partly as a result of bad enforcement mechanisms and lending institutions that as, I believe, Susan said or maybe it was Anne, that are essentially unregulated, we can talk about a level playing field. We can also talk about a race to the bottom and in the house where I grew up my mother always said she didn't care what the kids down the street were doing. My rules were that I had to do the right thing. And I think that the same thing should hold for examiners and for regulators, that we need to make sure that the people that we're in charge of policing are doing the right thing, whatever the kid down the block is doing.

MR. ROBERTS: Pat.

MS. McCOY: I agree with Tommy that much of this discussion is about nonbank mortgage affiliates or operating subsidiaries and just to follow up on Diane, the trend is for subprime operations to move within the holding company structure. So I'm less and less concerned about the level playing field because I think that these operations are moving within regulated structures as it is.

The other thing I wanted to say is that if you look at the geographical operations of these affiliates or operating subs, the concept of a CRA assessment area is virtually irrelevant. Right now, I am going into the foreclosure files for Hartford County, Connecticut and the examining subprime lending patterns, loan by loan by loan, case by case by case, and the highest incidence of problematic subprime loans are among subsidiaries or affiliates of banks that have zero branches in Connecticut. I notice the same thing in Ohio when I lived there.

MR. ROBERTS: Tommy.

MR. FITZGIBBON: I wanted to clarify something. I think there may have been a misunderstanding earlier when I was talking about Long Beach. I don't want anyone to interpret that what I said was that what they did was not predatory. It was predatory. So there may have been some confusion of how I worded something.

The real key to this, I think again, getting back to what's going to happen if the rules are amended to allow, in effect, a heavier scrutiny of bank affiliates, if their lending, their mortgage lending is coded in CRA or if the loans that they originate in the assessment area are coded. That is that perhaps for the first time is that the mortgage affiliates will get a better evaluation of their controls, of their compliance, of their training materials, of their focus in terms of products than they have before.

MS. DIEDRICK: You must have read a different part of the regulation than I read because my understanding is if you use the mortgages from an affiliate --

MR. FITZGIBBON: Yes.

MS. DIEDRICK: That is an affiliate under the holding company, that does not get an exam. No one goes in and exams it because you're using the loans from that affiliate.

MR. FITZGIBBON: Correct, but if they have abusive --

MS. DIEDRICK: Who's going to know if they're not examined.

MR. FITZGIBBON: That's true.

GOVERNOR GRAMLICH: There could be consumer complaints.

MS. DIEDRICK: There could be consumer complaints that may have been resolved and may not have been resolved.

MR. FITZGIBBON: I think perhaps even the threat is going to be enough in some places.

MR. ROBERTS: Let's keep in mind that affiliate lending activities are only included at the sole election of the bank itself. So it seems to me that given that it's a purely voluntary inclusion that doesn't seem excessively burdensome to apply this to activities both inside and outside assessment areas that are clearly violative of laws.

One other area in which comment is sought is with respect to the investment test. The regulators did not propose any changes to the investment test, but they do say they might provide guidance in several areas and seek comment. And these areas would be when community development activities outside of assessment areas can be weighted as heavily as activities inside of assessment areas, that the criteria of innovative and complex are not ends of themselves, but means to the end of encouraging an institution to respond to community credit needs. Third, the weight to be given to investments from past exam periods to commitments for future investments and to grants. And four, how an institution may demonstrate that an activities primary purpose is to serve low and moderate income people.

We only have about five minutes left, but I wanted to see if anybody wanted to weigh in on this. I might add that these are subjects that the CAC has discussed at great length in previous years, so I think there's already been a fair amount of discussion of them, but we do have some new members and some old ones as well who might want to just get in a comment.

MS. DIEDRICK: I would just like to make a comment on the concept of complex and responsive because I think that is one of the things we talked about yesterday.

The concept of complex and responsive is important because its role in the regulation encourages banks to undertake initiatives that go beyond routine investments such as purchase of mortgage-backed securities. It recognizes that the investment test should not be a pure numbers game which some people think it is.

It puts real weight on the effectiveness of investments that are responsive to LMI communities. At the very least, at the very least, this language should be incorporated into the performance context because it is what helps banks differentiate their investment portfolios from really outstanding to merely only satisfactory.

MR. ROBERTS: Other comments?

MR. VAN TOL: I agree with Anne, but I think the performance context thing is important because many of these $500 million banks, we're happy just to see them buy state housing bonds or something like that which are needed for rural communities, but are particularly complex or innovative.

MR. ROBERTS: This is one of the areas in which the current regulations have sought to add the qualitative factor to the quantitative aspects of investment activities. And those of us who work every day in these communities are very sensitive to the different qualitative effects of a given amount of investment within a community.

And oftentimes, those investments are difficult to make or require innovative of complex aspects and so to -- it's not that innovation and complexity are the end. The idea here is not to make life more complex or difficult for banks. The idea is to make CRA responsive to high priority community needs as possible.

And so that's really, I think, the spirit that I'd suggest interpreting this aspect of the investment test. You can have a very simple kind of investment or at least one through repetition has become simple. That's highly responsive and it's that responsiveness that ought to get at the credit, not the fact, not a demerit for its simplicity.

MR. ROBERTS: Dan.

MR. DIXON: Just one quick one, Hubert. Just anecdotally, we've run into a situation and I've had other bankers tell me that their investments, while numerically and quantitatively they were big enough, quote unquote, but they weren't creative enough. And the language in the existing supervisory guidance has been interpreted by some examiners to say it is a necessary condition that they must be creative, outside of the box and we think that's very inappropriate supervisory interpretation and anything that can be done in the new regulation to clarify that creativity is not a necessary condition, I think that's appropriate, because otherwise investing in your state housing bonds won't cut it.

MR. VAN TOL: I think creativity should be required for Chase, Citi, Bank of America and World Savings.

(Laughter.)

MR. ROBERTS: Perhaps with that consensus, back over to you.

CHAIR SCANLAN: Great. Thank you very much, Buzz.

Let's turn our attention to the next agenda topic which is rules on uniform standards for clear and conspicuous disclosures.

Pat?

MS. McCOY: Thanks, Agnes. By my count, at least six and possibly seven consumer protection disclosure statutes that are under the aegis of the Board require that disclosures be clear and/or conspicuous or something very close to that.

But if you look at the definition of the term "clear and conspicuous" across these statutes, the definition either is -- the term is either not defined or the definitions vary.

And so in a proposed rulemaking this past December, the Board proposed establishing a uniform standard for what the term clear and conspicuous means. And today, the Board has asked the Council for discussion of this proposal.

The motivation for the proposal, as I understand it, is that if you look, for example, at privacy disclosures under Regulation P where the format and to some extent the language is more heavily regulated or regulated in greater detail and compare those to disclosures under other statutes, that the Regulation P format seems to be easier to read. Now I'm not talking about the contents. We know that's another matter, but the format. And so the Board, in its proposal proposes extending the Regulation P disclosure requirements to other statutes that call for clear and conspicuous disclosures. This is an important adjunct of the Board's emphasis on increased financial literacy. If disclosures are not understandable, if they're not noticed, then it's very hard to have an educated consumer.

In discussions yesterday, staff also emphasized that the concern is not about most financial institutions. It's about outliers. So in the proposal, there's firstly proposal to model the standard after the current requirements and Regulation P in which the term clear would mean reasonably understandable and the term conspicuous would mean reasonably designed to call attention to the nature and significance of the disclosure.

In addition, the Board proposed type size guidance that has been effective in Schumer Box credit card disclosures and essentially the way this would work is that any disclosure in 12.5 would receive a safe harbor. Obviously, anything larger than 12.5 would receive a safe harbor as well.

Disclosures in point type less than 8 points would be considered not clear and conspicuous and then between that it could be clear and conspicuous but there might be circumstances in which it's not.

The Board has received comments, many comments from industry, on the one hand applauding the effort to have a uniform standard, but on the other hand criticizing the Reg. P standard as unworkable, as overly burdensome, as overly costly and as posting litigation risk.

With respect to burden, there's a concern that the rule would necessitate a change in forms that no sample language of forms was provided. There was a concern about integrated disclosures found in contracts and how workable that would be. With respect to litigation risk, one thing to consider is whether or not the standards are subjective in nature or objective. Objective standards are less likely to prompt litigation. And we had discussion which we can bring out today about whether or not the litigation risk is real.

Consumers generally applaud the proposed rule, some would like even stricter standards. Our task here is not to fly speck the proposal, but rather to propose constructive alternatives that we in the room could live with. There's a sense that the Reg. P standard would not be workable in all contexts, but I invite comment today on what would work.

And I'd like to start first by calling on Agnes.

CHAIR SCANLAN: Thank you. Just to reiterate a couple of the points that are of concern regarding this legislation is that there really isn't any significant benefit to it, in my opinion. I think that financial institutions support the goal of clear and understandable disclosures, but my point is mainly with the idea of the type set. I think having a specific type set, particularly of a 12 point means longer forms, means larger amounts of paper that need to be sent to consumers. It's also going to increase costs of mailing, printing, which goes, in turn, to the fees that we give to consumers. So there would be more cost, more paper.

There was another discussion that we had in terms of having sample language. There was a request of the Fed to provide sample language like in the privacy notices. I'm not looking for any additional sample language. I think at this point there's enough regulations that provides that sample language. I don't see sample language as being a safe harbor. I don't know, however, that there's a significant litigation threat, but I'm not interested in having additional sample language. I do think that the possibility of different types of type set could also cause redundancy and perhaps some confusion for the consumer. Some of the terms might have to get changed. Certainly, the actual forms would have to be reviewed again by lawyers and by other entities within the institution which again could increase costs, but I do think that the guidance from the Fed could be perhaps let's look at the font, let's make it more of a broader suggestion as opposed to a specific type set. I think if we're asked to look at the type from the standpoint of, from a common sense perspective, look at the type and perhaps increase it, but not give us a specific number, I'd be much more interested in that type of a direction as opposed to a specific type set because many of our different forms can range from 5 point to 100 point. I actually checked on this yesterday.

So different forms can result in different ways and I think that if we have a broader suggestion from the regulators, that would be much more helpful in my opinion.

MS. McCOY: Bruce.

MR. MORGAN: Agnes and I disagree.

CHAIR SCANLAN: One of the first times I've seen financial institution or bankers disagree, but it was fun.

MR. MORGAN: While the proposal on clear and conspicuous is intellectually attractive, I think as economists describe externalities or unintended consequences might result from the proposal that's on the table today.

As a community banker and most community banks in America rely on outside vendors to provide electronic forms for our platform systems and this proposal is sweeping in that it would change five regulations at once and impact a number of forms in our institutions.

I think the timing, the costs involved in reviewing all of our current forms to see if they comply with the new standards, haven't been taken into account in the proposal. And I would request that the Board consider withdrawing a proposal and spend more time studying what the impact will be. Agnes asked for positive suggestions, or Pat. I would think one suggestion would be as these five regulations come up for review and revision, that we do it incrementally, and do provide sample forms and do provide example model language. I'm not so concerned about the litigation threat as I'm concerned about the fact that take the Truth in Lending disclosures. We've got probably 20 years of case law and legal precedent where some of these disclosures have been tested and all of a sudden what do we mean by clear and conspicuous? And what impact will that have on some of these prior precedents? Does that start a whole new wave of suits because your forms aren't in compliance?

So I think the issue of timing, the issue of costs, and a lot of what I've been presented about the proposal does relate to form, not substance, but form. And I'm not sure if form is where we really need to be focusing. Yes, every consumer in this country wants simpler language. Yes, every banker wants these forms to be simpler. So we're on the front line having to explain them and yes, I would like to have some guidelines, but we in the community bank area need some samples from Board staff as to exactly what they mean when they say clear and conspicuous.

And if it is a Schumer Box, to clarify Reg. Z or consumer loan, give us a sample.

Finally, a lot of community banks today have websites. They have a number of electronic * (10:32:47) mechanisms and electronic platforms and electronic disclosures out there and I'm not sure clear and conspicuous, where we focus on form, type size and issues like that can be implemented very readily on a website that may be using hypertext protocols, or some other protocols that the type size may be in compliance. If I can hand you a piece of paper, but if I give you an electronic disclosure all of a sudden we're no longer in compliance with the disclosure. So I'm asking to withdraw it, study the impact, incorporate these changes of clear and conspicuous over time and then alternatively if it is adopted, then I would recommend that it be clarified that the current disclosures, if they comply with current laws, are adequate and allow the industry sufficient time to incorporate over a two-year cycle or three-year cycle, whatever it takes to get these things implemented. But just to do it as a sweeping change on five regulations, without really considering the externalities or unintended consequences that you're creating, I think that's what my concern is.

MS. McCOY: Speaking as a lawyer, these forms have limited life spans as possible and I think that it is important to work with industry to give adequate time to make the changes. But the time span that Bruce mentioned sounds perfectly reasonable.

Ken, you had an interesting idea yesterday that I thought might be worth airing now.

MR. BODELON: Are you sure?

(Laughter.)

MS. McCOY: Yes.

MR. BODELON: During the discussion yesterday on consumer credit, I think Fed staff was, they were looking to us for suggestions on two fronts. One dealt with the shelf life of existing forms and if there is a consensus, we can maybe agree on two to three years because regulations do tend to change. It's obvious that Congress is not happy with all of the disclosures, therefore the regulators are not happy with the disclosures, therefore the public is not too happy with the disclosures.

The other was some kind of assistance, in our view of what clear and conspicuous is, what is the definition. Terms such as noticeable, easily understood were thrown around and I just probably should not have volunteered anything, but I know I appreciate when we look at a lot of information and consumers are looking at a lot of information that we have often an executive summary. And an executive summary basically perhaps has 10 bullet points of what the meat of the paper or document really is. And perhaps that is a logic that we could flow through in the disclosure process where you have some form of short executive summary of what the meat of the disclosure is and perhaps those bullet points could be referenced to the entire legalese, if we have to provide that for an overabundance of caution that financial institutions tend to have. But perhaps that can be tied into the disclosure process.

So it was an idea and given the shelf life of forms and the lead time, an 18-month period of lead time seems reasonable before you're allowed a reg to give people opportune time to get the programming all reprogrammed, get all the forms taken care of to meet the needs.

It was just an idea and I'll leave it at that.

MS. McCOY: Dennis, Diane, Clint, Forrest, Mary Jane and Anne.

MR. ALGIERE: Thank you. As bankers, certainly we wholeheartedly agree with the clear and conspicuous standard which, by the way, has been around for many years and believe it is working. And there's really no evidence, overwhelming evidence that it is not working and I really would like to hear any evidence, if there is any.

I'll just touch on a couple of issues. One is the cost. We certainly agree with the comments made about the costs associated with changing not only forms, but software, websites. It's going to be a huge cost to the industry that will include retraining and any time we make these type of changes, there's a cost associated with it.

Secondly, it's almost -- we're adopting Reg. P model, standards, and there are folks out there who are complaining that that language isn't working. Those disclosures aren't clear and conspicuous. So I'm just kind of confused why we're going to a regulation which there is, some folks are saying this is not clear enough and we need to make changes with Reg. P.

Also, the fact that I feel this is going to open up a floodgate of litigation. Reg. P, as you know, does not contain any language dealing with civil liability whereas the regulations we're looking at in the proposal do contain provisions for civil liability and firmly believe that this will cause a floodgate of litigation against banks.

MS. McCOY: Diane.

MS. THOMPSON: Dennis stole some of my thunder. I was going to point out too that clear and conspicuous is not a new standard. As we said yesterday, most of the litigation on clear and conspicuous died out with TILA simplification and where we see clear and conspicuous as a litigated issue these days it tends to be about did they take -- did the person actually receive the disclosure? Or when they were handed the disclosure were they circling some other piece of paper and saying this, we really want to focus on the interest rate, don't pay any attention to the APR. And I'm not convinced, even as somebody who likes to look for technical TILA violations for a living, that this would open up. This gives guidance, this would give some safe harbor and it really is just an interpretation of, as you've said, an existing standard.

Benjamin raised in the previous discussion why don't we ever talk about financial education. I think this is financial education. And I really applaud the Board for trying to make the disclosures more meaningful. We spend a lot of time talking about why people don't read the disclosures. You see disclosure after disclosure get layered on top in an attempt to make it more meaningful. We all agree that it ends up with too much and too hard to read and this is really an effort to get us back, to giving information to the consumers in a form that they can use.

And there are certain things that we all know about how to make things more readable. My college professors always said it had to be 12 points and you had to have inch margins and double spacing. I'm not sure that we need to go that far, but there are things that we know about margin sizes, about font sizes, about short simple sentences, about headers, about summaries that work. And I really applaud the Board's efforts in that direction and I think that we should all support the move to make the disclosures meaningful to consumers and to give them to consumers in a way that they can use.

Headers allow people to scan for what they care about. Even if it's more paper, it gives people an opportunity to find what it is that's important to them and to use the disclosures in a meaningful way and I think this is really the heart of what we can do for meaningful financial education because these go to everybody.

MS. McCOY: Clint.

MR. WALKER: Great. On behalf of the credit card issuer that I work for I am actually very greatly concerned about this proposal. Everybody, I think, reads that clear and conspicuous is something that everyone should strive for and as the Board staff has said, in most instances it is met by most of the issuers.

My concern is that some of the comments made by several of my colleagues here I think this truly is going to open up a floodgate of litigation. When you apply a Reg. P standard which is a format standard as opposed to a substance standard, so it talks about white space. It talks about headings. It talks about putting in plain language as much as you can and when trying to describe complex financial consumer transactions in plain language, it's not always easy to do.

I think you are going to create a whole new raft of litigation against the issuers. And I think as a representative of a fairly small issuer, that is troubling to me. We do everything we can to make our disclosures as conspicuous as possible. We try to do headings. We try to do it all, but it opens us up to second guessing by creating this artificial standard, I think is going to be very, very problematic.

And the thing that concerns me the most is that you're creating a whole new structure for disclosures when there hasn't been a finding that there is a serious problem out there. And what I would suggest and I want to go to what Ken said a little bit, is that we withdraw this proposal, have the Board go to those areas where they do think there's issues with clear and conspicuous standards and then come up with a set of proposals on where they think those issues are and the issuers, the banks will work with them.

I think Ken's proposal, for instance, for maybe a so-called executive summary is a great thought. That's, in essence, what the Schumer Box on credit card solicitations. And if you want to do other kinds of disclosures, we should work on it, but it should be frankly one type of disclosure after another. Mortgage documentation is different is greatly different than credit card documentation and is greatly different from other loan documentation. And it's got to be different for each one. If you want to do something like that, each one should be specifically analyzed and a concrete proposal drafted with regard to specific things, not this whole broad cover the whole waterfront type of disclosures. I just think it's not only going to create costs, but is going to greatly hurt and frankly stymie innovation in disclosures for most issuers.

MS. McCOY: Thanks. I have Forrest, Mary Jane, Anne, James and Lori.

MR. STANLEY: I just want to follow up on something Clint said. I think we've got the cart in front of the horse. I don't know -- I have not seen any evidence of a perceived need for this change. In my institution, every complaint that comes in through a regulator, whether it's the OCC complaint center or any State Attorney General or whatever gets reviewed by someone on my staff and I can't ever remember a complaint on clear and conspicuous. I mean I just -- we obviously agree a disclosure has to be clear and conspicuous to be meaningful. I don't think there's any disagreement on that.

To me, it's a cost benefit analysis. At a time where we all agree identity theft is a problem and we're all going to be going through enormous system changes to comply with the Fact Act requirements, to spend the money, if the regulation got adopted in its present format which would cause us to redo forms, would cost us to reprogram systems, it just does not seem to be worth whatever the incremental benefit might be.

There's money better spent on lots of the other compliance and regulations forthcoming under the Fact Act.

GOVERNOR GRAMLICH: Could I ask a question about that? Isn't now the time you'd want to do that if you're looking at all your other forms?

MR. STANLEY: No. I don't think so because I don't think under the Fact Act there's going to be any change that I can think off of the top of my head of the 16 or 18 sections that are going to require me to re-look at my loan documents. And those are the ones that would cause quite a bit of reprogramming.

MS. McCOY: Mary Jane.

MS. SEEBACH: I'd also respectfully request that the proposal be withdrawn. The concern with form over substance in this area I think seems misguided and using Reg. P as the standard when I think most institutions at this table have probably already had to redraft their privacy proposals several times. Lots of white space, but nobody understands what's in between the white spaces.

I also think that the reality is that without simplifying the concepts, the actual concepts that we're trying to disclose, making them reasonably understandable doesn't happen just with font size standards and headings. You know, the required disclosures are often quite complex and cannot be explained, actually, without using technical business and legal terminology. So simply making sure that there are headings and graying and other things is not going to make that easier for the borrower to understand.

I also think there are a number of state laws that have already indicated that 8 point font is perfectly acceptable. I think Connecticut and Texas allowed that in their contracts and I think that for the Board to set a standard higher than that obviously throws a lot of lenders into this little flux between their federal regulator and their state regulator.

The other thing is I do think that there is this potential for unfortunately very technical litigation that doesn't get anywhere. I mean if the contract is otherwise a good contract, but someone wants to get out of it and on a technical violation I don't think that does any of us any good.

I think that's it.

MS. McCOY: Anne.

MS. DIEDRICK: First, let me say that it's vitally important that all consumers understand the terms and conditions of the financial instruments that they utilize, but second the five affected regulations, B, E, M, Z and DD, already mandate disclosures be clear and conspicuous or readily understandable. And I also know of no history of consumer complaints about the clarity of disclosures.

The adoption of a new standard would not clarify them or improve their understandability and therefore there appears to be little, if any rationale for making these sweeping changes and I also respectfully request that the Board withdraw this proposal.

MS. McCOY: James

MR. KING: Working in a community where most persons who live there are just glad to get a loan so disclosure is like okay, I'll sign, where do I sign. And we find that more true in simple document -- a document like a loan closing for a house. We learn that people will go set the table without a lawyer and sign these papers and walk away, not understanding really what they've signed. And what we've tried to do over the years is kind of take the glaring eye look issues and put them on paper and make sure they understand those things.

We took the risk as a nonprofit and acting like a lawyer in some cases because we're saying to them, here are things you should understand and why you're signing this. I think there is a need for those issues that should be summarized, just understand basically what they're signing. Because they're not going to read -- we don't read all those documents so the expectation for a person in a neighborhood to read those is unrealistic. So if it's 8 feet high or 12 feet high, give me the loan, I'll sign the papers. Because they believe the only thing I have to do is pay the monthly note. That's the only thing you asked me to do. All the stuff in this document, the only thing that I'm required to do is to pay the note. Forget about the interest rate, the points, what the cost of closing is going to be, it's not an issue for them. It's not a question that's even asked, just sign the documents and get the house.

So I think a summary at least gives them a talking point. Each closer, each title company sends a closer who says these are just things the government says you have to sign. And they sign it.

MS. McCOY: James, thank you. If I could just intersperse a comment. I think it's too late in the day to say that there is no problem, at least in certain specific areas.

We have digested now the GAO report on predatory lending and there's a discussion in that report that the current disclosure scheme is not working in the area of home mortgages. There's actually been economic studies of the effective Schumer Box disclosures and a finding that over time increasingly these disclosures became very successful so that consumers do not focus on APR disclosures.

So we have some evidence about what works. We have some evidence that certain parts are broken. We may want to consider drawing from some of the new behavioral economic studies to conduct further experiments on what does work and does not work, but I think in the meantime one thing that's very attractive about Ken's executive summary proposal with the bullet points is that it doesn't require any existing forms to be changed. It's a free-standing document with the summary. It's separated. It's very easy to read and I think there's really a lot of merit to his idea, as modest as Ken is.

And then Lori.

MS. SWANSON: Thank you. What we're talking about is the implementation of laws passed by the Congress. The Congress has deemed these are important consumer rights and what we're talking about is making sure that consumers adequately understand the rights that they've been given under these various regulations and laws and I applaud the Board and Federal Reserve Staff for trying to struggle with the issue of how do we make sure that consumers do understand these laws. Is it clear, meaning, do we understand the words that are actually written? Is it conspicuous, meaning do we understand or can we see it? Is it shaded in such a way that we can actually find the statements?

And speaking from a State Attorney General's Office, I can tell you that we get complaints all the time from consumers who don't understand their financial rights under these laws, the mice-size print, that it's buried, that they have these rights, but they don't know what their rights are. And it's a frequent area of complaints that we get in our office because of the way things are drafted or the way they're laid out in documents. And there is a whole body of research out there from folks who deal with this every day. I don't know what clear means, what does conspicuous mean? I think that in the regulations here suggested by Board Staff, it is things like using short sentences, using the active voice, using plain language headings, wide margins, bold facing the words. Those are very simple things that the research has shown will help consumers understand what their rights are. Things like font size do matter. Minnesota State Laws, for example, all kinds of laws that we have at the state level. Heading aid distributors have to use 12 point fonts. Tax preparation services, 28 point font. Travel clubs, 14 point font. Those kinds of rules were passed because there is a feeling that consumers do need to have things laid out conspicuously in order to understand what their rights are.

I think that I too would think that an executive summary, as Ken suggested, makes some sense, because you do struggle with the issue of brevity versus simplicity and an executive summary would very clearly lay out for consumers what their rights are and then if they want to delve deeper they can do that.

CHAIR SCANLAN: Just a comment regarding your remarks, Pat. I remember last year we were having a briefing from one of the research assistants, research persons here at the Fed on the TILA disclosures and I believe from those discussions we were told that there was a survey and a statistical analysis on the understanding of those TILA disclosures and I think we were told that even after 20 plus years consumers don't understand these disclosures, but yet they're assigned and they continue to be used.

We were having this discussion in the context of the privacy notices and so I would say that I think financial institutions again and we all applaud the goal of supporting clear and conspicuous language, but I'm not certain that this particular language here of this regulation is going to get to that fact, looking at the fact that these TILA disclosures and other disclosures that have been around for a long time, still from a statistical perspective, are seen to be confusing to some consumers.

MS. McCOY: Agnes, if I may, what was interesting about that study, if I recall is that if you concluded that you drilled consumers about how APR is defined, for example, they cannot tell you how it's defined, but what they understand is that it is a standardized measure that can be used to shop apples and apples.

And that is a very useful thing and that's what TILA sought to achieve. So in that sense, it's worked marvelously and today, there's evidence that from the 1980s increasingly people understood that the APR is the best way to shop for credit, given current disclosures.

CHAIR SCANLAN: But that goes to the financial literacy too. It goes to educating consumers more about what they're reviewing, as opposed to just a document in and of itself.

MS. McCOY: But the two interact. The evidence shows that people began to focus on the APR once the Schumer Box was adopted because it's such an easy thing to read.

MR. DIXON: Just quickly, I move that we appoint a subcommittee to include James and anybody else who wants to be on it and if we can come up with some ideas for the disclosures which his customers will read, then the rest of us will be more than happy to consider them.

GOVERNOR GRAMLICH: Is that true, will the rest of you be more than happy?

CHAIR SCANLAN: We'll always consider things.

GOVERNOR GRAMLICH: I bet.

(Laughter.)

MS. McCOY: Hattie?

MS. DORSEY: I support the idea of an executive summary because I agree with Jim that the constituents which we serve have to understand language and oftentimes the language is not understandable by certain constituencies.

I would also like to suggest the model many of us sitting around the table have CDFIs or manage CDFIs. And our language in those documents when we provide lending to certain community groups have to be understandable and so I will offer up taking a look at the language that we use and our lending documents that really appeal to a certain constituency and that's the group I think we're talking about, really trying to understand the language.

So I would offer up as a part of the committee that was recommended that we include in there some other forms and some other documents that get at certain populations.

CHAIR SCANLAN: Hattie, you can be the subcommittee chair.

MS. SEEBACH: At the risk of also being appointed to the committee --

(Laughter.),

-- I think most of the institutions here probably already prepare a document that accompanies at least in a mortgage transaction the disclosures that go out that try and explain the terms on the federal disclosures. At my institution, we've also created a basic understanding your loan terms document which is loan specific and goes into such things as you do or you do not have a pre-payment penalty which will be repaid in X amount of time. You do or do not have a balloon loan. You have or have not financed your closing costs or you're bringing them to closing. And especially in transactions where there's a rescission period, it's one piece of paper that they walk away with that has their note rate, their total closing costs and they can walk home and say I have not a clue what the rest of this means, but this thing summarizes the terms of the loan I just closed. And I can take that to my brother-in-law or whoever it is and say did I get a good loan or not?

And I don't know if we've got enough white space or enough headings on that document, but I think at the end of the day it's much more useful to a borrower than me putting a lot of money into putting pink and green on a paper that otherwise has concepts that are not understandable to the borrower.

MS. McCOY: Mary Jane, I will say that I got a purchase money mortgage from one lender who is represented in this room last summer that did not have in any way such a summary. And it would have been very helpful. But that's by no means a ubiquitous practice among mainstream lenders.

Are there other comments here? Am I missing anybody?

If not, Mark?

VICE CHAIR PINSKY: To speak as a consumer, because I'm not expert, I'm not a banker. I'm not an expert in this. I also like Ken's idea or Mary Jane what you're doing in some way. One of the things that I reflect on as I listen to this conversation is the number of times in the last year and this year that I've heard bankers and lawyers who are part of this council say I don't really understand what's in those documents.

(Laughter.)

Let's be honest about it, right? James, it's not just folks you're financing, right?

We don't always understand everything that's in there and maybe you can't unless you're a lawyer and you really take the time to look at it or you go to a lawyer and you spend a lot of time and money doing it, but there are certain material things that you really need to understand. I mean Mary Jane talked to some of those and it's really important that we find a way to make that clear. Maybe it happens already, I don't know. I try and do that when I refinanced my house, but I think it's just a point that we cannot lose.

MS. McCOY: Bruce?

MR. MORGAN: To piggyback on that point, a whole cottage industry has emerged of companies to go around to try to explain to bankers what the staff commentary from the Reserve Bank really says about Reg. C.

(Laughter.)

GOVERNOR GRAMLICH: What size point is that in?

(Laughter.)

MR. MORGAN: And so when we talk about this type of change, as sweeping as it is, I think Ken's got a great idea. I think we can all learn something from it, but in the things that we hand out in staff commentaries to explain what this regulation or this disclosure is, maybe we could practice what we're trying to regulate. Maybe we could have simple sentences, words that we all can understand the meaning of.

And so I would still say I think this proposal needs to be withdrawn until the Board staff can give the Board ample opportunity to incrementally implement it as we go across the various regulations and study what the real impact is. What ball are we really trying to put in the goal? Is it to have consumers understand the terms and conditions of the credit? Or are we just off in the form and not in the substance of what it's about?

MS. McCOY: Other comments? If not, I would really like to applaud the Council members for coming up with some concrete alternatives. I really think that this advances the discussion.

And I'm very, very pleased that we were able to flesh them out. I also call on the Board to draw further on the collective expertise of both the entire Council and any committee that might be constituted from it in working on a possible positive alternative. And with that, I'd like to save our remaining time for an expanded discussion of the GAO report.

CHAIR SCANLAN: Let me just ask Sandy and Anne if perhaps would you like for us to begin that discussion now and then break at 11:15.

MS. McCOY: I think we should break now.

CHAIR SCANLAN: Come back at 11:30? 11:15, okay. Why don't we all come back at 11:15 then. Thank you.

(Whereupon, the proceedings in the foregoing matter went off the record at 11:02 a.m. and went back on the record at 11:15 a.m.)

CHAIR SCANLAN: Okay. Why don't we go ahead and begin the conversation on the General Accounting Office's Study on Predatory Lending.

For a second there, I was looking around saying, "Oh, I don't see Janie." I do see you, so why don't you begin our discussion. This was a topic that three of our committees, three of the four committees, discussed yesterday. And Janie is going to lead the discussion.

MS. BARRERA: Thank you, Agnes. The study reviewed the impact of predatory lending on elderly consumers, and the report finds that elderly consumers, particularly those with limited income but substantial equity in their homes, are more susceptible to predatory lending.

So the study suggests, then, that there needs to be monitoring and examination. So the study suggests that Congress consider providing the Federal Reserve Board with this authority to monitor and examine the non-bank mortgage lending subsidiaries of financial and bank holding companies to ensure compliance with predatory lending practices.

So as Agnes stated, there were three committees that actually talked and discussed this. We had plenty of time to review and discuss, and in our particular committee there were some issues that were raised. And one in particular was the cost associated with this monitoring and examining, the enforcement authority, and also the lack of a level playing field, meaning, you know, who in fact is being examined or not.

And so to begin our conversation, Anne is going to start on that particular issue.

MS. DIEDRICK: Thank you, Janie. Actually, this morning I also touched on this situation where banks and their subsidiaries, their mortgage subsidiaries, receive very rigorous fair lending examinations, and that there are other lenders that are either subs of holding companies or non-bank lenders, some that are wonderful lenders, but none of which get the scrutiny that examined entities -- lenders get.

I believe that the GAO has made an excellent recommendation. At JPMorgan Chase we believe that the best offense in the war on predatory lenders and their abusive practices are regular and rigorous examinations for all mortgage lenders. While this recommendation will not cover all lenders, it is a giant step in the right direction.

MS. BARRERA: Thank you.

Mark, you also had some comments to make?

VICE CHAIR PINSKY: Well, one of the things that we focused on a lot yesterday in trying to get our arms around this issue, and we all know this is an ornery and a slippery issue that is very difficult -- you know, there are different ideas about how to define this, there are different ideas about how to intervene with this -- was one of the points that seemed really to jump out from the GAO report was drawing the distinction between an approach and a reason for putting it at the Fed was to draw -- draw the difference in approach between an examination approach, such as the Fed or other bank regulators take versus an FTC approach, which is really a prosecutorial approach after the fact.

And we spent a fair amount of time talking about the clear value to consumers of having -- of an approach that might prevent or stop or slow or impede in some way any predatory practices that are going on versus what happens to folks after they've lost their home or after, you know, bad things have happened and how to go about that.

And it seemed to us that -- or I think it seemed that there was a pretty clear agreement that an examination approach is a well-suited tactic to begin to get at this, recognizing not -- you know, recognizing that it doesn't reach everybody, that there are other issues that need to be addressed, but that it is a significant step forward, as Anne suggested.

MS. BARRERA: Baby steps are good.

Mary Jane?

MS. SEEBACH: Well, as the infamous "unregulated lender" at the --

(Laughter.)

-- table, I have to just tell you that I have a staff of 20 that assist me with my unregulated responses to the 40 plus states that license and examine us. At the end of the day, obviously, I of all people, have no problem with noting that the Federal Reserve is a fine regulator. It's --

(Laughter.)

And I think the reality is the study reached the same conclusion that most congressional actions do. If Congress can't figure out how to address a problem like predatory lending, they normally punt it over to the Fed and say, "You guys will figure it out. How about some examination?" So that would be good.

It's interesting to note -- and I think someone else -- I think Sheila raised this point as well -- this is a report that was requested by the Senate Committee on Aging, yet -- and it talks about the fact that there isn't really any comprehensive data on the impact of predatory lending on the elderly, yet it calls for a study on how to determine that or, you know, the request for additional data.

It also sets forth that there are at least 25 states and 11 cities and counties, including the District of Columbia, that have predatory lending laws. It goes on to say, then, that some federal regulators -- they have, you know, three initials -- OCC, OTS, for example, that have preempted those state laws as to their banks and as to the op subs of those banks.

It fails to note that the non -- the infamous unregulated lender that is a member of a holding company but not an op sub gets no benefit from that federal preemption. We still comply with all of the state laws, including all of the state high-cost laws.

The report fails to note that many of the OCC and OTS regulated institutions are, in fact, bringing their sub-prime entities in under their banks, so that they can take advantage of this federal preemption that the OCC and the OTS are moving forward for two reasons.

One, AMTA was taken away last year, so if they want the ability to charge prepayment penalties on ARMs in states where they are otherwise restricted, they need to have it as an op sub. And, secondly, to get out of the state predatory lending laws, which are incredibly complicated, especially from a programming standpoint when you're a multi-state lender.

The report notes that state officials and consumer advocates maintain that federal preemption interferes with the state's ability to protect consumers, yet the report fails to acknowledge that the majority of state mortgage regulators, sometimes distinct from state banking regulators -- I think a lot of people here are familiar with state banking regulators. There are usually -- not in all cases -- distinct agencies that deal with state mortgage regulation -- do, in fact, regularly examine state licensed lenders.

And I encourage Board staff to make contact with the American Association of Residential Mortgage Regulators, who would be very happy to talk to you about their role in regulating lenders.

The report notes that the number of enforcement actions by the FTC are often triggered by state regulators. The study notes that a Washington State regulator had an enforcement action to get back 700,000 to its state borrowers. It also references the First Alliance settlement, which was a combined action of private plaintiff's counsel, six states in the FTC.

The Delta Funding case was actually something that was initially stirred up by the New York Banking Department, who has a very rigorous fair lending exam when they come out and look at us, I must tell you.

So the -- let's see, I have something more to say here. Oh. The -- I would note that, as I noted earlier, I have 40 plus states that regulate and examine me. I also have the OCC that comes in and takes a look at our small bank. We also have the Federal Reserve, who I love best.

Of course, for purposes of assessing compliance risk across the broad enterprise, so we've had some discussion about this. They come in and have discussions with us about the infrastructure in place to address compliance, and I think feel quite free to drill down at any point if they felt I was lacking in a particular control.

If we get the Fed looking at mortgage and other subs, it would be an additional level of scrutiny for me that I think other mortgage lenders that are only state regulated would not have to address.

And, therefore, I obviously view it was an unnecessary addition to my workload -- let's put it that way -- and especially in the absence of any indication that mortgage lenders within the holding company are more abusive than lenders outside the holding company that are also not federally regulated.

I also had a question. Is there an expectation if the Fed came in, would they be looking at the state law requirements and the high cost state law requirements in addition to the federal requirements that the other federally preempted institutions only have that looked at?

So there are a number of things that I think would make this more onerous for the "non-regulated" mortgage lender.

Thank you.

MS. BARRERA: Pat?

MS. McCOY: Yes. It seems to me the question here is: what type of enforcement tool do we use to apply laws that do apply to all boxes in the holding company structure?

And as Anne points out, currently we have an unlevel playing field in which the operating subsidiaries of national banks and federally chartered thrifts are subject both to enforcement action and to examination, whereas the non-bank subsidiaries directly of the holding company that are not owned by the bank are not subject to examination by federal authorities -- the federal authorities -- that are charged with enforcing the laws generally.

So it seems to me to have a level playing field, at least within the holding company structure, we should seriously consider extending Board examination powers.

Furthermore, in the sub-prime mortgage industry, there has been terrific industry consolidation in the past few years. And the trend is that the small fly-by-night mortgage originators are disappearing, and those operations increasingly are being brought within the holding company structure.

I think that's a good thing, because I think it scrutinizes those operations to give greater scrutiny, and you have the chance for more uniform enforcement of consumer protection laws. But that is only realized if we examine for problematic practices, if we try to nip the problem at the bud rather than wait until we have a full-blown disaster on our hands.

MS. BARRERA: Sheila, I know that you have some points that you wanted to make.

MS. CANAVAN: Yes. First of all, I agree with the GAO recommendation and some of the comments made here today that -- the suggestion that the Board embrace the recommendation that the Federal Reserve examine is a good idea. And I agree that the enforcement is much more difficult than prevention.

But I'd like to focus on two other issues. With regard to the lack of data, I think a good beginning there would be for the Fed to send a letter to the Senate Committee on Aging and recommend that HMDA be amended to require reporting of age. That would be a beginning, and then folks could begin, including at the Fed, to do some research studies of this problem.

I also think, though, that in addition to the letter the Fed should consider revising the regulations to require reporting of age immediately and not wait until five years from now or something. I just think that based on the HUD-Treasury report in 2000, and based on this study, we know that this is a problem, and it has been a problem for a long time. And I think it needs to be addressed on an urgent basis, and we can't continue to ignore it.

I'm sure that it has been ignored in terms of how we get this data, just because there is so much going on in the world. I don't think it's intentional, but I think we all know and care about our senior citizens, and we have to do more to protect them.

That leads me to another aspect of the study. My practice is primarily dealing with elderly consumers. And in terms of consumer education, I think that the report is right on. First of all, what consumers need to be educated about is the changes in the marketplace. And, in fact, it is a marketplace.

Elderly citizens grew up at a time when they went to a lender down the street and talked to them, and we are cautioned and receive their consumer education about the lending process from their local banker -- you know, provident lending governed.

And now it's a sales culture marketplace, and elders don't know that. And they have great difficulty in protecting themselves because of it. I think that lenders can go a long way to address this problem by making consumers, including elderly people, aware that they have to be a lot more careful than they used to be.

And I think there has to be more transparency. I think lenders have to change the job titles that they use for people who are interacting with consumers. They should not be telling people that loan salesmen who work on commission, or who work on -- receive compensation based on the amount of product they generate for the lender -- they shouldn't -- consumers shouldn't be told that they are dealing with a loan officer because they are not.

They should be told they are dealing with a loan salesman. And if they go into a bank, and if they -- and they see a little card like we have here, it should say, "Sheila Canavan, Loan Salesman." It shouldn't say, "Sheila Canavan, Loan Officer." And then a consumer will know right away, oh, oh, well, what questions should I ask, such as, do you work on commission?

Lenders should be transparent about that. Consumers should not be led to believe that they are dealing with a loan -- traditional loan officer who earns a salary. The world has changed, and consumers don't know that.

And so I think that although financial literacy is a good idea that should start in kindergarten, or maybe nursery school, and then get more sophisticated as kids move on up, I mean, they should learn how to set up a savings account. They should learn how to balance a checkbook, and so forth.

But in terms of, are we going to solve the predatory lending problem in terms of transactional consumer education -- in other words, is there any way that we can possibly arm a consumer to go out into the marketplace and tell them what they need to ask to get a good loan, I really think we can't do that honestly. I don't have a lot of faith in that, and part of it is because the marketplace is changing so rapidly.

Every week there is new loan products, and so forth. We would have to give them a four-year college education in the market, teach them about the secondary market, which really dominates and drives the primary market, and it is in fact the primary market now, and then we'd have to make sure they had continuing education -- you know, every month go in and learn about the new stuff.

I mean, it's really unrealistic and unfair to lay this, you know, on the consumer and say that they can possibly protect themselves. I'm a lawyer, and I have a lot of trouble interacting with this marketplace and getting straight answers.

So, and it's not fraud. It's just -- it's the sales culture. And, you know, people -- salesmen learn to address a question with another question, redirect the conversation. You know, so I think we have to be quite -- work hard together to let consumers, Congress, everybody know it's a different ball game out there.

GOVERNOR GRAMLICH: Sheila, could I -- I wonder if I could ask you about just one thing you said. It's about the age data on HMDA. Suppose you knew that -- from the HMDA statement that you had a loan and may have a certain APR, and this, that, and the other thing.

Are you saying that it's important to know whether the borrower was 67 as opposed to 47?

MS. CANAVAN: Yes.

GOVERNOR GRAMLICH: Why?

MS. CANAVAN: Because I think 47 -- as the report points out here, 47 year-olds may not deal with some of the same cognitive impairments, you know, that a 76 year-old deals with. They also may have grown up at a time, as I said, where the culture was different.

A 47 year-old might be more aware that, you know, getting a loan is more like getting a car these days. I mean, there's lots and lots of reasons. In California, for example, we have an elder abuse statute. It's Welfare and Institutions Code 15.600, and it specifically talks about the problems that elders have in the world, that they have trouble getting lawyers. You know, lawyers don't want to represent a client for two or three years, and then the client dies before you get to trial.

There's all kinds of things that impact elderly people that are different than others. For example, a lot of elderly people are on fixed incomes. You know, a 47 year-old is probably hopefully still working. There are many, many, many distinctions that can be made. But perhaps the primary one is that they are targeted for the equity in their home.

And lenders have ways of avoiding this from becoming obvious to regulators. For example, in their marketing, they will ask, you know, title companies and companies such as Data Quick who gather information for them, for names and addresses of borrowers who have lived in their homes for a certain number of years.

Well, that's a code for, you know, an elder who may have a lot of equity. I know that, you know, but somebody else might know that -- might not know that. So it's a complicated subject, and it probably deserves one of our subcommittees taking a closer look at it.

But I think that HMDA is a beginning. It's a beginning, and we can take from that the opportunity to compare pricing for elders, for example. There's a lot of things that the research department here and elsewhere could do with that information.

MS. BARRERA: Ruhi, and then Hattie.

MS. MAKER: Governor Gramlich, if I could piggyback on that point. What Sheila says is exactly what we see as well. One of the things you often see is with elders -- are women who are widowed or divorced and their husbands looked after their financial matters. And they are prime targets, you know, and they are not necessarily uneducated.

One of our clients is a teacher who is a retired teacher. She is a white woman who lives in a rural area, and she was mortified at how she had been taken advantage of. And one of the -- there is almost like a reluctance factor to come forward once they realize how they've been abused to say -- to have to admit that, yes, we were completely ripped off.

And they are so embarrassed, and they are so ashamed, and so one of the first things we try and reassure them is that, look, it wasn't that you weren't smart enough, that other folks who took advantage of you were much smarter, and that this is a system of pattern and practice. And that's often how we convince them to be willing to be represented by us when they realize that it's not just them, that this is a systemic practice.

The way I see it is, you know, well, we talked about earlier with CRA, that's the first baby step. And in my, you know, sort of waving a magic wand view, this would be the next step, that, you know, the Fed would embrace this, because remember what happens with CRA. An affiliate gets -- we call it cherrypicking, but gets chosen.

You know, certain things under CRA are not going to be covered because a financial institution is going to say, "Well, I don't want this lender included in the analysis." This widens it and, as Anne said, levels the playing field. And essentially, we talk about cost. But when I see -- the cost I see is -- in Rochester I see, you know, properties that are vacant, property values that are declining, our tax base is down.

You know, we -- I mean, upstate New York is in serious trouble, and I'm not trying to simplify and pretend that there aren't other economic reasons that that is not the case. But I do see why -- you know, time after time that the way things were, where it was a predatory loan and where folks were foreclosed on or where they walked away from, and that's an enormous urban cost that we are going to see increasingly.

And as Sheila says, this is going in and -- not in an after-the-fact fashion that, like the FTC does, but going in up front and looking to see where these abuses are. I think once the Fed has the power, I think that alone is going to have a power for the lenders to look and stop some of these practices.

GOVERNOR GRAMLICH: Okay. The question -- I'm not saying that these kinds of things don't happen. The question I'm raising is: would you have us in our HMDA ask age data in addition to the other data? I mean, I guess I'd like to hear banks on this issue, because I've heard banks on HMDA a fair amount, and I think I know what they're going to say.

But I'd like to hear them on this issue, and I suppose you're raising the broader issue of whether there ought to be different lending standards for aged people as opposed to other people. And this is a new idea. I mean, and if -- if there's a lot of interest in it around the table, then so be it.

But I'm just pointing it out as a new issue, and I'd like to hear some other people talk about it.

MS. BARRERA: In response to the Governor's question -- Susan?

MS. BREDEHOFT: Basically, this has been identified as a problem, and I would have no problem collecting age. Now, it's not something that we could do immediately, because systems would have to be changed. But I think that we want to identify where abuses are occurring and if we can do something to stop it.

Really, I think age would be a pretty easy thing to collect. Right now we're required to collect date of birth under the USA Patriot Act, so we would have that information in our files.

Compared to the HMDA changes we had to implement this year, collecting age would be, in my opinion, a very easy task. Now, I don't know if you want me to stop there, I do have other comments that I'd like to make.

MS. BARRERA: Can we just leave that? Because I know Tommy and Dennis want to respond to the Governor's question.

MR. FITZGIBBON: Yes. I don't think there would be any problem. Again, it's a programming issue. It actually, from a business perspective -- and I tell you, we -- the banks who are in the mortgage business really look at the demographic profiles of our customers anyway.

This is just another good analytical tool of trying to figure out who is our best customer, who are our best prospects, and being able to identify them in just a general business perspective. But I think it also -- when we talk about a level playing field, when we get down to who is looking at the data -- age and other information -- is really looking at the -- whether or not the non-regulated banks -- and not necessarily the ones in this room -- but the --

(Laughter.)

-- the unregulated, if you will, or state-regulated independent banks, their HMDA data sucks, frankly. It's just not very -- very good to begin with, much less -- because we've taken over a couple of them. We have ended up trying to clean up the mess.

And so part of it is that they are not being looked at right now. The states do a very bad job -- well, let me put it this way -- not all states. Illinois does a bad job --

(Laughter.)

-- of examining, if you will, compliance for mortgage banks and mortgage brokers in our market. They just don't do a very good job. They don't have enough people, and the people aren't very well skilled, if you will, in looking at these issues.

So I think it is -- it does get back to a level playing field. Who is providing the information, and is it valid?

MS. BARRERA: Dennis?

MR. ALGIERE: Certainly, as a bank, I mean, collecting the age is not -- not a huge issue, and that's something, you know, we would consider. But I just wish we could get all our data together once and for all to do it. It just -- it seems that we trickle, and we're making changes as we go down every year or so.

And I just wish we could just come -- consensus what we want to collect, and let's do it. It's just -- it gets -- it's just, you know, another change that we have to make internally, which is not -- not a big deal, but it can be done, and certainly don't object to age.

The other question I have is, I mean -- and, Sheila, I've heard some stories from you over the last couple of days. I'm glad we got to speak, and some of the stories are horrendous. I mean, the predators out there unfortunately aren't the ones who are going to be reporting the HMDA data. And if they are reporting it, Tom, I agree with you. It's probably not going to be accurate.

MR. FITZGIBBON: Right.

MR. ALGIERE: And what's the follow up? You know, we have regulators that come into our bank and examine us, and they do look at a number of issues outside the HMDA area, including age. They look at, you know, guarantors, co-signors. They look at a number of things. They look at, you know, those folks who are getting paid by commission. They want those lists.

But, you know, I think we've heard this before. The folks who are the predators, unfortunately, if they are collecting and they are reporting who is examining and who is following up and is the data -- is the data accurate.

But to answer your question, Governor, certainly collecting the age is not -- not a big issue. But I just wish we could just all come to a consensus, what do we want to collect once and for all, and let's do it and --

(Laughter.)

-- because it's just -- it's another change -- training, software changes, forms, clear and conspicuous.

MS. BARRERA: Bruce, and then Dan.

MR. MORGAN: Governor, the collection of the data is simple. For community banks, one of the issues about HMDA is having to fill it out. For a small community bank in the 32-, 33 million range -- I understand you're going to raise it to 33 million -- the reporting may not have a sufficient number of data points to even fill out a HMDA table.

We can gather the data. That's not the problem. I would like some research at some point by the Fed on if the HMDA standard were raised to be more parallel to the CRA, how much data would we lose? How many data points would we actually lose? So it's not the problem of reporting age. It's the problem that HMDA is pushed down to a level that I think at some times the data aren't meaningful, because there are so few data points in the real small institutions to really have much impact.

And so as you think about this, you want age, great. And I think it would be great to have the statistical analysis, so that we really know where the problems are. But alternatively, how much additional data are we getting by pushing HMDA down to $33 million institutions? And I don't know.

MS. BARRERA: Dan?

MR. DIXON: A couple of things. First, to respond to Bruce, part of the tradeoff there is that much of the predatory lending, we bankers believe, is done by mortgage companies. And they're of a size that it is really important to get the data on them. So that's a tough tradeoff.

Okay? If you move that number up substantially, then you won't get any data on the mortgage industry. And to my young friend here, trust me, the rules will never stop changing.

(Laughter.)

But what if we stipulated that there's an issue with seniors, then what? I mean, what strategies do we have to actually solve the problem, or -- I mean, I'm legitimately interested in some ideas.

MS. SMITH: I just want to make one small observation, which is that the 33 million threshold applies to depository institutions. There is a different test for non-depositories, so --

MR. DIXON: But if you raise that from 33- to 500- for depositories --

MS. SMITH: Right. There would --

MR. DIXON: -- I assume that the brokers will have a point of view --

MS. SMITH: -- will want --

MR. DIXON: -- about their threshold as well.

MS. SMITH: Yes, the level playing field.

MS. BARRERA: Hubert, is this in response to the Governor's question, or are we changing here?

MR. VAN TOL: Well, I was talking about the level of HMDA, so I don't know how that fits in.

MS. BARRERA: Okay. Well, let's -- Hattie, you've had your hand up for a while.

MS. DORSEY: I wanted -- I think some of my comments really relate to some of the conversations that just went on with the banks. And I'm speaking from maybe an unintended consequence when we really include in there the age, even though I agree wholeheartedly with the statements made by Sheila.

But in my own self-interest, I'm thinking about the time when I retire and I want to downsize, and I go in to the loan officer of my local bank, and what kind of considerations are going to be made based on my age. And whether or not, based on whatever rules and regulations are part of the decision-making consequences there, that I'm denied the loan based on my age, or the fact that maybe I might only have 10 more years to live or 15 years to live.

So I think about the unintended consequences of laws and regulations. And so while I am in agreement, in principle, about the age discussion, I think that we sometimes have the other side to contend with.

The other part of the conversation has been around, you know, the predatory lender. A lot of this came about because of the concerns raised by community groups about what was happening in neighborhoods that was undergoing change and the asset-based stripping for the seniors as they began to refinance based on the predator coming and knocking on their front door.

And the seniors, of course, suffered mightily in this process. And then there was laws passed by counties and by cities to try to negate this, and then the state stepped in and I think neutralized a lot of what individual cities and counties have done.

There has to be a uniform rule, and I believe that the Feds are the best group to take -- to tackle this. On the other side of it, it needs to be user-friendly, and it needs to be understood with reference to the counseling that takes place. And I don't expect the loan officer that it has to filter down to, to be that agent, and I don't have the answer as to how to make it user-friendly.

MS. BARRERA: Hubert, then Susan, then Diane.

MR. VAN TOL: Well, I think we have all stipulated that we want the Fed to embrace the GAO study. So we've sort of moved off to the topic of age and limitations of the HMDA data.

And, Bruce, you'll probably kick me for you having brought this up, but that 33 million only applies to institutions that have a branch in an MSA. And so one of the problems in rural areas, and one of the things our organization has done is you can now get the data directly from the county offices. And in seven Iowa counties and 15 Wisconsin counties we have compared the HMDA data with the actual mortgage documents.

And in an MSA you'll typically see that there's about -- that HMDA covers 80 to 90 percent of the number of mortgagee's documents. In the most rural counties, it's down around 15, 20, 25 percent, and that's because of the role that those small community banks that don't have a metropolitan branch play in those communities. And that's a huge distortion of what the data means in rural counties, and people have to take that into account and look at it.

MS. BARRERA: Governor Bies, you have a question?

GOVERNOR BIES: I guess I'd like to hear some discussion to follow up on a couple comments that if we did follow the GAO recommendation -- I want to understand a little bit better about the nature of the state process right now, looking at these non-bank holding company subs. Specifically, are they only looking at state compliance, or do they look at federal compliance?

Are they using an enforcement prosecution perspective, or do they -- are they using an examination focus the way our examiners traditionally do? How frequently they look at it? And also, for those of you that are in more than one state, do you see any consistency in the quality of the process?

We've heard, you know, one state is clearly not doing a good job, but other consistency issues. I'm trying to get an understanding -- if we go in and do the non-holding company -- non-bank subs of holding companies, how does that compare to the stand-alones, and where will there be conflict in level playing field issues? And so anything that you can give me as to the process in that would be very helpful.

MS. BARRERA: Mary Jane, then Pat.

MS. SEEBACH: They look at both state and federal requirements. I mean, it's very standard for them to look at Truth in Lending and RESPA and ECOA. New York is the most robust in the fair lending context. They actually come in and do a whole month fair lending exam.

GOVERNOR BIES: Is that because it's done by the Banking Commissioner?

MS. SEEBACH: The regulator in New York is the state banking authority.

GOVERNOR BIES: And do you think that's why it makes it more consistent?

MS. SEEBACH: It could be. It could be. I will tell you that New York invited -- the first year that they launched their fair lending exam for us, they invited a number of other states to join them, and, sadly, they couldn't come. But --

(Laughter.)

So we just have dealt with New York so far. And they also, of course, come in and examine for high cost -- cost as well as a specific New York high cost.

They do -- I mean, remembering that in 40 plus states -- I mean, we manage over 7,000 licenses for our folks, and we -- the threat is always, would you like to continue lending in the state? And if you fail the exam, then you lose the license. A number of states have now gone to individual licensed loan officers, so we have to, you know, register all of them. If we have a bad actor out there, they can single them out pretty quickly.

Are they consistent? No. You know, there are some that are much better than others. And I will say, Illinois used to have -- and maybe something has changed, but, I mean, Dea Brennan used to call me and, you know, have Assemblywoman so and so on the line and, "Mary

Jane, would you please explain to her why her borrower is out on the street from a foreclosure." You know, that kind of thing. There were pretty aggressive, so I'm surprised to hear that. but the -- you know, different states are definitely better than others.

MS. DIEDRICK: We have both New York State Banking Department and the Federal Reserve Bank of New York conduct concurrent examinations. They both do an excellent job, and I think it really helps that the New York State Banking Department works so closely with the Federal Reserve Bank of New York in these exams. And I think they learn a lot from one another.

But we also have operations in other states where the banking departments are invited in, and they don't show up either. So I --

MS. SEEBACH: None of mine don't show up. They all show up, but it's --

MS. DIEDRICK: No. They call in. It's too much --

MS. SEEBACH: I'm in Southern California, so everybody shows up.

MS. DIEDRICK: -- of a travel.

(Laughter.)

They call in. They call in for a conference call at the beginning and then one at the end.

MS. BARRERA: Pat, and then Bruce.

MS. McCOY: The state that I'm most familiar with is Ohio, which I lived in for 10 years in the '90s. And what I observed in Ohio is that you can, as Anne suggests, have a situation where the banking department or, in some cases, another department, if we're talking about a non-bank mortgage lender, although it has the power to examine doesn't do so or doesn't do so very frequently.

And sometimes the question is politicization of the process. Sometimes the question is severe understaffing, and in this age of state budget crises that's a big problem. And we -- we saw both of those in great abundance in Ohio.

So if you don't have the state agency showing up to do an examination, then it doesn't matter if it's state laws or federal laws that they can look at. They're not looking at either.

The final thing in Ohio is that the state Unfair and Deceptive Acts and Practices Act did not cover mortgage lending. So the state law actually is very, very narrow. And so even if they did show up, I'm not exactly sure what they'd be looking at.

MR. MORGAN: Governor, I served two terms on the Kansas State Banking Board and was the past chairman, and we brought mortgage lending under the Banking Board, as well as consumer credit. And in our state we regulate 270 banks in the banking department, but we found 3,500 mortgage brokers and entities doing mortgages in our state. And we are self-funded through assessments.

But Kevin Glendenning, who is the Deputy Commissioner, heads up that division, has done an excellent job looking at both federal compliance and state law compliance in examining these entities, and has sought and has obtained civil money penalties, and has barred some of these entities from doing business in our state.

So in terms of looking at a model of a fairly aggressive state enforcement in examination and review of lending activity in the mortgage area, Kansas has done a reasonable job.

Now, I also do loans in Missoura -- or Missouri, depending upon --

(Laughter.)

They have not done the same consistent job across the state line, and the mortgage area is somewhere else in state government and is basically starved for resources. But in our case, it's funded through assessments to the banks through the fees that the mortgage brokers and others have to pay for their licensure, etcetera.

And so we've had a pretty good track record so far, but it's an activity -- I think we're probably in our third or fourth year, and it did take some changes in state regulation to have the tools to actually make something happen, like civil money penalties.

MS. BARRERA: Ruhi, and then Buzz.

MS. MAKER: If I could address your question, Governor. For New York -- from the New York perspective, you know, there is talk about -- Delta was talked about, and Household is the other one that the State Banking Department was involved in. And both of those were not exam-identified problems.

They were identified because consumer lawyers -- and in the case of Delta, the legal services program in Brooklyn -- had identified lots and lots and lots of consumers, which were then referred over to the banking department. Similarly, with Household, ultimately there were 300,000 people in the settlement, and they were very much aware there were lots and lots and lots of problems before finally the banking department would come in.

And that is not to belittle the banking department, because I think we've all heard that the New York Banking Department does a very good job, but it's a question of resources. You know, there are limited resources, and even what they've done very well has been as a result of once the horse is already out the barn door. And lots of people have already lost their houses.

So this model where you go in, you do use some of the data with the higher cost loans to do some preliminary analysis and say, "Well, here is where so many high-cost loans are." I think Dan had mentioned that you don't want everyone in there.

You see someone who is making, you know, a large number of loans which are five, six, seven, eight percent above that trigger, and you go and you say, "Let's look at some loan files." And I think that's something that the Fed is suited for, and then you are consistent across the states. So that's where my perspective is.

MS. BARRERA: Buzz?

MR. ROBERTS: Yes. Just to bring this back, I guess, to the main focus of the conversation -- relatively few problems occur directly within insured depositories. Really, the main problems are outside that, and this is sort of getting back to the point that Anne had made.

One of the reasons that that is the case is that the federal banking regulatory scheme with its examinations and the other things that come along with it, such as if you're going to do examinations, then your HMDA records have to be in pretty good shape or it's going to show up, and then you're going to have a problem with that.

That whole structure seems to work well, and is -- what we are trying to do is get at this really pernicious problem of predatory lending, which exacts huge costs on consumers and on neighborhoods, and more broadly in the confidence of the public in the financial system for the country, which is just crucially important to our success socially and economically.

And so if we could harness the Fed's credibility and capacity and experience in structure and systems to get at a big hunk of the other mortgage lending activity that is right now not examined in a consistent way, that would, we think, be a big step in the right direction. So we would just urge you to consider that.

MS. BARRERA: I just want to make sure that the questions are being answered for you. Okay, great.

Dennis, and then Susan.

MR. ALGIERE: A have a question, if I may. When does the FTC get involved in the enforcement action after you receive complaints?

MS. MAKER: Thousands of people have complained. It's huge. It's huge. I mean, I don't know if the other consumer lawyers want to pitch in, but it's -- it's -- when there has been a huge clamor and exposures and stories in the press, I mean, that has personally been our -- what our experience has been.

MR. ALGIERE: And they do not conduct any examinations.

MS. BARRERA: Susan, and then James.

MS. BREDEHOFT: I have an idea, so here goes. The FFIEC collects all of this data, and part of the process is I know for banks -- and I don't know if they do this for non-depository HMDA collecting institutions -- they analyze the HMDA data, and based on certain fees or tables, one of which is a disparity ratio, they create lists for the regulators to say, "You need to go in and look at this bank. We don't like these HMDA statistics."

And then, to that list I believe they add a random sample of banks that the regulators are to perform a targeted, fair lending examination.

Now, maybe the FFIEC -- we could use their analytical resources to target depository HMDA collector -- mortgage companies and submit similar lists to those companies' primary regulators to say, "You need to go in and look at these companies."

Now, that assumes that the data is correct. All right? And I really can't speak to that. The added benefit that we will have in -- or, rather, that the regulators will have next year is the fact that we will be collecting interest rate spreads, and that mortgage lenders have to indicate if they are making HOEPA loans or not.

So that could assist the FFIEC in targeting the higher rate lenders and things of that nature. Anyway, it's an idea.

MS. BARRERA: James?

MR. KING: There was a question asked earlier about if we collect this data on age -- going back to age again. How would it be used to protect the elderly in our communities? How would we use that data to help us protect the citizens of our community?

MS. CANAVAN: Well, to respond to the Governor's question, and to Hattie's point also, I was not urging new standards in terms of the terms and conditions of loans, mortgage loans for example, for elders. I wouldn't suggest that a lender be barred from making an ARM loan to an elder, although generally I don't think it's a good idea.

I think that could be addressed in terms of best practices and also enforcement.

For example, in California in that elder abuse statute that I referred to, if by clear and convincing evidence an attorney is able to establish that an elder was defrauded, then treble damages and attorney's fees may be awarded by the court.

So there are lots of different ways, if we gather the data and study it, and determine that this truly is a problem, then there are lots of ways we could address it without depriving elders of access to credit, which is very important, I agree.

MS. BARRERA: Diane?

MS. THOMPSON: I actually also wanted to address Hattie's point, which is of course they can't refuse you a loan because of your age. That's illegal under the Equal Credit Opportunity Act. And nothing that Sheila is proposing would change that, and they already -- all banks already collect information about your age, in terms of your date of birth.

So Sheila's modest proposal to collect -- to make available in aggregate form this data, which banks already collect, wouldn't change existing anti-discrimination laws, and I think that's important when we talk about unintended consequences is to remember how one change fits into the existing structure of law.

I want to talk a little bit more about some of the points about enforcements versus exams. Ruhi is right, and Hubert and Pat and everybody who has talked, Mark, about how difficult enforcement is, and how late in the process it comes.

And as someone who sits in an office every day and looks at people who are losing their homes, are threatened with losing their homes, there is nothing I can do at that point to make them whole. Even if I stop the process, and even if I win the lawsuit, there is nothing I can do to undo the damage that has been done.

I can't undo it. I can't make people whole. And I can't begin to serve everybody who has a problem, and that's me and the same thing holds true of any enforcement agency. Any of the banks around the table will say that the examination process makes them pay attention to what they're doing, gets them into shape, and is a preventative measure.

We talk a lot about the importance of prevention in this area, not wanting to impose an additional regulation and additional civil liability. This is a way to address the bank's concerns about additional civil liability, and much, much more cheaply really remedy the problem of predatory lending in a meaningful way.

Now, so I think that's part of where we come from is that we look at this -- and this may not be the final solution to the problem of predatory lending, but it seems to many of us intuitively, yes, examinations, holding people accountable at the front end, rigorous examinations that look at some low-level data, are very, very important.

And then I think there is the harder question, which must be the question that the Board is wrestling with which -- and which Congress will have to wrestle, which is, okay, so if we believe in examinations, where does it go? Who exams it, and where should it make sense?

And I think for many of us we look at the Fed and we look at the Fed's ability to do examinations. We understand that this would mean adding staff, but we also understand that the Fed has expertise in doing rigorous examinations in all of the states. The Fed has currently enforcement authority for many of the laws that are covered by predatory lending, and wide familiarity with the process.

And it's hard for me to think of another agency -- in some sense to answer Mary Jane's question about why the Fed, I mean, it's hard for me, and perhaps there is some other place that it would be better -- it's hard for me to think of any other agency in the federal government that has all of those criteria, that has current expertise in exams, authority to enforce many of the significant regulations beyond unfair and deceptive acts and practices, but TILA and ECOA and substantive regulations.

So that I think is part of why to many of us it seems like this might be a workable first step. And I understand the concerns, too, about a level playing field, but we have a dual banking system. And what we have now is a very unlevel playing field, which is that if you are a non-bank subsidiary, you have just state regulation and the possibility of FTC action if you really, really mess up in a big, big, big way. And that state enforcement is very uneven.

Mary Jane talked about getting phone calls from Dea Brennan. I submitted lots of complaints to Dea Brennan, and sometimes she called me back, but she never got me on the phone with any lender to resolve the problem. And that's the same as an exam. That's an enforcement thing that is driven by a political reality and driven by a persistent complainer. It's not the same thing as doing something preventative.

So I think that the level playing field now is not level, because you have a whole group of financial institutions that are not examined. And I think Mary Jane's concern is, well, I'm going to be concurrently examined by two entities. Well, we already have that. We have that for the Federal Reserve state member banks. We used to have it for the OCC. And if you're in New York, you probably still have it if you're a national bank.

So I don't know that -- I think that the concerns about the level playing field militate towards imposing these exam requirements on the non-bank subsidiaries.

MS. BARRERA: Dennis, and then Dan.

MR. ALGIERE: Yes. I just want to -- I agree with your comments, Diane. That's what I was trying to get to earlier. With the FTC, it's after the fact. And I think it's a very fundamental solution. Those who are predators aren't examined, in my opinion, in most cases -- in most cases.

And you mentioned HMDA data -- FFIEC looking at HMDA data. I would venture to guess those who are predators are not going to be submitting accurate HMDA data, because no one is going into their bank and examining the data integrity that the Fed does, that FDIC, OCC, and also maintaining the internal controls to make sure that you're not doing what you shouldn't be doing.

So I think it's very fundamental. I think those organizations must be examined the same as we're examined in this room, under the same scrutiny. And the question is -- is who better to do that. I think -- I agree with you -- the Fed. Whether or not they have the resources, that's up -- you know, for you to decide. However, I think they are better equipped than the FTC.

But from -- what I'm hearing today is the FTC comes in after the fact, or they pick up the phone and give you a call for representation after the fact, and it shouldn't happen that way. There needs to be measures in place, and I think it's very fundamental. Examine these institutions, examine these companies, the same way we get examined.

GOVERNOR BERNANKE: I suppose the concern would be that it's not just a question of level playing field and sense of fairness, but I guess the problem that -- if there's such a discrepancy in the level of attention that abusers would just migrate to the other system, and it might not change the overall incidence that much.

So that -- I actually agree with you that we need to address the people outside the system. How do we do that? This report unfortunately doesn't deal with that very effectively.

MS. THOMPSON: I would just say that it's true, it leaves a portion out. But it does deal with a substantial segment of the market, which is now outside. So it's a step towards reaching to some of the people that are unexamined currently. And there's another step, but I think it's a first step towards addressing that problem.

MS. BARRERA: Buzz?

MR. ROBERTS: It's easy for a financial services holding company to migrate an activity from within a bank to an affiliate still within the holding company than to actually move it outside the holding company. So maybe this doesn't solve the entire problem, but it would solve a big hunk, an important hunk of the problem. And let's not let the best become the enemy of the worst -- of the --

(Laughter.)

MS. BARRERA: Well, as we started this conversation, it was taking baby steps, and I think that was a good way of putting it, Buzz, in conclusion.

So, Agnes, we're done.

CHAIR SCANLAN: Thank you very much, Buzz and Pat and Janie, for leading the discussions that we had today on the three major topics.

Now we're going to move into the Members Forum, which is a standing agenda item on our Thursday meetings with the Governors where Mark Pinsky, the Vice Chair of the Council, and also President and CEO of the National Community Capital Association, will talk about the CDFI industry in transition.

Mark?

VICE CHAIR PINSKY: Thank you. Let me see if I can get this set up. That was easy. Is this on? Can you hear me -- the mike? It says it's on. Is that better, or no? I'll speak loudly.

Thank you all for giving me a chance to talk a little bit about the CDFI industry. I think that in the last 10 years the CDFI industry has gone from being just completely off most people's radar screens to being maybe a little blip on the edge of most people's radar screens.

But, in fact, the CDFI industry has begun to play a more significant role first of all in the world of financial services, particularly as it relates to CRA but not only as it relates to CRA, and in community development policy more broadly.

And, in addition, you know, many folks here either work with CDFIs, are on the boards of CDFIs, run CDFIs. And what I wanted to do today in a few minutes, as briefly as I can, is talk a little bit about the CDFI industry, what it is, what it isn't, and just very briefly talk a little bit about some new data on the CDFI industry that is imperfect, but it is the best data we've ever had on the CDFI industry, and then talk a little bit about how the industry is, in fact, in -- I think in the beginning stages of a very major transformation that we -- we don't know how it's going to come out. We have some ideas about it.

In your packet is a copy of this presentation. Particularly, I want to get to the numbers. I'm not going to go through all of the numbers, so if you want to look at those feel free.

In addition, I'm going to hand around -- I have a few copies to look at of two documents. The first is one use of some of the data on the CDFI industry that is pure comparisons of CDFIs that you just might be interested in. And the other is actually our new strategic plan. When I talk about the industry and transformation, a lot of the thinking came out of the process that we did on that.

So if I can make this work -- I'm going to do it manually, if it'll go manually. There we go.

I want to talk a little bit about what a CDFI is, in fact, because the notion of -- and it's not really strictly defined, and the idea of what a CDFI -- a lot of different people have different ideas about what a CDFI is. Very simply, a CDFI is a private sector financial institution. It may have some government money or some public support in some ways, but it's essentially a private sector financial institution, and it has a primary mission of community development, which gets defined in very different ways.

In some places that's community development defined in terms of job creation or business financing. In some places it's housing, and that might be anything from rental housing, multi-family rental, to single-family home ownership. And also, community facilities, everything ranging from, for example, child-care facilities to health-care facilities.

That primary mission -- one of the things -- and this is something that comes out of a key, but not necessarily the only defining definition of a CDFI is what was in the CDFI law, the law that created the CDFI fund in the Department of the Treasury 10 years ago, in 1994.

And they used something that the industry had suggested, which we call the parent test, and that simply says that if the mission of a subsidiary is community development, in order for that whole institution -- in order for that subsidiary to be able -- or the subsidiary affiliate to be considered a community development financial institution, the parent also has to have a mission of community development.

So there are many banks around this table. There are many other organizations that do outstanding community development finance work, but the mission of the parent is not per se community development. So they're doing great work. They're contributing. They're certainly key players and major players in the community development finance system, but they would not qualify under what we would term as CDFI or what -- what the federal government under the CDFI Fund would define as a CDFI.

There are basically four types of CDFIs, two are depositories, two are non-depositories. Community development banks and community development credit unions are the depositories, obviously, and venture funds and loan funds are the non-depositories.

There is disagreement about what a CDFI definition is, and it's not -- those things I just put up there are true, but there are different interpretations of them. The industry has one sort of perspective on it, and the CDFI Fund and the Department of Treasury, over the course of 10 years, has -- in our mind -- has sort of redefined that.

And if you'll just jump down to the bottom, there are two areas where the CDFI Fund has veered from what we think that really means. And this has -- this has importance, as I'll talk about in a second.

The first is governmental control, whether it's a private sector financial institution or whether there is in some way that -- a government entity of some sort -- it might be a governor, it might be a mayor, might be an elected official of some other sort -- exerts real control over the organization -- for example, appoints -- has the authority to appoint the board chair, or has some say so over loan decisions, for example.

And the other is the level of financing activity. The CDFI Fund has said that a substantial amount of the organization's -- of the CDFI -- of an organization's activity has to be financing in order to qualify as a CDFI, but has defined "financing activity" to include all training and technical assistance that might go along with the credit prior to a credit decision.

So that in an extreme case you could have an organization -- and these are important organizations -- you might have, for example, a microenterprise lender who does -- spends one percent of their activity on making loans, and 99 percent on capacity-building and potential borrowers. The CDFI Fund would qualify that as a CDFI.

The industry says something a little bit different about it. It basically says that it's got to be either a majority of their activity or at least has got to be an integral part -- the financing has to be an integral part of what they do.

Why does it matter? The CDFI Fund certifies CDFIs, and it used to be a really great thing to say -- for some CDFIs to say, "Gee, we're a member of National Community Capital, because they have some standards, and that's a good thing." But it became a much better thing to say, "I'm a U.S. Treasury Department certified CDFI," right, and to be certified you have to pass those tests.

That has important meaning, because that certification gives -- has meaning under the Community Reinvestment Act. If you're a certified CDFI, that gets you in easily, if you're a bank looking to work at it. Other federal CDFI programs -- the federal CDFI program in Treasury does, other programs use that definition. There are a number of state programs, and then there is that perception of just saying, "I'm a Treasury certified CDFI."

In fact, that certification speaks not at all -- this is an important point for the Fed to understand as well as the banks to understand. Saying you're a Treasury certified CDFI does not necessarily say that you're a quality organization. We hope you are, but it does not necessarily say that. It simply says you meet the statutory requirements.

Quickly, on one point, there is confusion about what is a CDFI and what is a CDC, or a community development corporation. You can be both, right? There are different definitions that come in some way out of government definitions, and some ways out of industry definitions.

Some CDFIs are also CDCs. The difference that I would say is that a CDC in my -- from my perspective, but not everybody would agree with me, is primarily doing development work. It is a developer in some way, right, and it may be different types of community development. It might be housing development or otherwise, and the CDFI is doing the financing of that development. So CDFIs and CDCs work together extensively.

The data I'm going to present are actually from something called the CDFI data project, which is a CDFI industry collaboration that is trying to begin to get its arms around some key statistics on the industry. And it is -- at this point, we are looking only at sort of organizational-level data. We have not yet figured out how to get transaction-level data in a consistent way, and so it has clear limitations.

In addition, you'll see in some of the data here some things that look anomalous, and that is because, in fact, we had trouble getting data on some of this. So this is not a perfect data set, but we've been working on this for five years, and it's a lot better than it was a year ago.

So, in addition, I will just say that this -- all of these -- this is the first time we've actually disclosed any of these data from the data project. We will have a report in about a month that I will, everyone, which will be a much more comprehensive picture of the industry.

But basically, what we know from the 442 CDFIs that were in the data project sample -- if you ask the Federal Government, they'll tell you there are about 600. The CDFI Fund will tell you there are about 600 CDFIs. We were only able to count 442. It doesn't mean that's -- there aren't more.

There is a little more than $10 billion in assets. Ten years ago we were a little over $1 billion in assets. You get some idea of the volume of the activity that we do. We work in all 50 states -- urban, rural, and reservation-based. Elsie has mentioned that her organization works very hard at native and reservation-based CDFI capacity-building, and we finance a wide range of activities.

I'm not going to try and go through all of these numbers, but just some basic numbers. For us, the important numbers are the net chargeoff numbers in 2002, which are better than we expected, particularly given what the economy was doing in 2002.

And for some people who raised the question, "Are we taking enough risk?" we think we are. But are we taking enough risk? And for other people, it surprises them by thinking that by the -- the fact that they're as low as they are.

The delinquency numbers -- you'll note that the loan funds -- community development loan funds in the far right column are higher than the others, and that's because they are unregulated institutions, and they have greater capacity, generally, to work things out or greater tolerance to work things out than regulated institutions are likely to have.

Again, I'm not going to go through all the numbers, but I'm happy to answer questions.

We also look very much -- Debra has talked a lot this week about community development impact, and we try and look very hard at that and try very hard to figure out how to measure that. These are some of the main metrics that we try and look at -- that jobs created are maintained, businesses financed, the housing units -- these are all 2002 data, just for the record. We need facilities.

And for depository institutions, CDFIs, we looked at first accounts, and then across the board looked at IDA holders. And it's important for us to be able to capture this, because CDFIs are not going to produce the financial yield that you would get in other investments, although in the current market we haven't done so bad. We haven't looked so bad.

But we do produce significant benefits to the community. Last year Janie did a wonderful presentation about ACCION Texas and the remarkable job that it had done in Texas in creating jobs and businesses and successful businesses.

This is one of the places where I think you'll see some skewing of the data, in part because I think that the loan funds -- we've been collecting data on loan funds for almost 20 years, and we're better at sort of coming up with jobs numbers, for example, than I think some of the other categories of CDFIs are.

So having said all that sort of helped, I hope, to explain a little bit what the CDFI industry is and what CDFIs are and what we know about it today. We actually think that the CDFI industry, as we know it, is coming to the end of its life and is about to go through a very significant transformation.

In part, the industry has comprised -- you know, depending on who you -- how you count them -- 5- or 600 generally small, vertically integrated organizations that, frankly, are pretty inefficient and have very little system -- you know, industry system.

And that has grown up over a long time, from the first 24 years of our lives, what we would call sort of the startup phase. It was really proof of concept. For most of that time, most investors -- and at that point very few banks were investing -- most investors -- a lot of it was religious institutions and foundations and a few socially motivated investors -- didn't really believe that this was going to work, that you could lend money to this financial intermediary that was going to lend money to non-conforming deals without exception, and that you would get paid back in the end. All right? I mean, that was the basic question: would it work?

And then, for most of that time you were talking about institutions that had very little or no capital, and, frankly, very little lending experience, and trying to do something that was sort of outside the mainstream.

And as we began to gain credibility, we also got very lucky through the '90s for a few reasons. One, the economy grew, right? We all know that. We all benefited from that, or most of us benefited from that. In addition, we had a President who -- in Bill Clinton who took an idea that George Bush, Sr. had proposed and made it his own, and made it into a law with the help of some folks in Congress that created the CDFI Fund.

And that was -- although the amount of capital from the CDFI Fund -- I had mentioned earlier we had grown about $9 billion, the CDFI Fund had put out a little under $500 million in that same period. The fund was not -- the capital of the fund was not alone the main source of growth.

The main source of growth in capital actually came from banks, which were the fastest-growing source of capital into the industry, partly motivated by CRA, partly I think motivated by the recognition that as -- as one banker said to me in about 1996 or 1997, "You serve sort of our undermarket. It's important to us that there be someone that's cultivating that market, but we don't know how to do it and it's too expensive for us. You're good at it. We want to work with you." And so that happened.

But as the economy changed, and as policy changed, and the focus on policy changed, I think the industry started going through some -- really 2001, 2002, started going through some very -- I don't know, hemorrhaging is probably as good a term as there is for it. And we're just beginning to see the effects of that now.

The economy changing obviously affected portfolios, although in a presentation that was in the packet that we looked at -- or we didn't look at yesterday, but it was in one of the committees yesterday, after several years of watching CDFI portfolio performance through the economic downturn, in fact, portfolios have performed pretty well. And you can see that in the chargeoffs and the delinquencies. But we're lagging in sort of tracking our data. We expect things to continue to get worse.

But the other thing that really happened when the economy turned down was that it affected foundation endowments. And CDFIs require foundation contributions, without a doubt, and foundations -- the amount they give out is determined by how their -- how their endowment performs, and that has also had a significant effect.

Coupled with a lot for a lot of foundations who had a lot of fun with us in the '90s as we grew, and everything went really well, was a kind of funder fatigue, where they simply said, "We think this is great. We support it. But we have to do other things as well." And so those things combined actually to really put a lot -- put real brakes on growth and on operational inefficiencies, which is not a bad thing.

The other thing that I think is starting to happen is that I think there's a general recognition -- certainly there is within my organization, that for all of the gains we've made, all of the growth we've had in our -- sort of the assets we manage and the fact we manage $10 billion -- I remember when we hit $1 billion that was a big deal, $10 billion seems like a big deal.

The problems we exist to deal with in many cases are getting worse. The income gap is growing greater. The wealth gap is growing greater. And I think in part that's because in this structure we have we focused more on, how do we grow the assets of these individual institutions, rather than, how do we really think about how to have an impact at scale? How do we actually take this and take this to some level where we make a structural and a systemic difference rather than a small difference as an industry?

I mentioned the operational inefficiencies. I think people are really starting to think about, how do we create out of this sort of large network of small institutions some systems that create a greater opportunity to sort of move the scale.

And Tommy FitzGibbon has actually done a lot of work on trying to provide loan-servicing solutions, for example, to CDFIs. It's one of the great inefficiencies. Every CDFI -- almost every CDFI does its own loan servicing, and, frankly, does it pretty badly and does it very inefficiently. It's an area where we can begin to make some difference.

And as these data are sort of just maybe the tip of the iceberg, we need to create more transparency to the market that we're trying to deal with, both the investor market, the supply capital market, and to our borrower demand market. And we're beginning to try and work on that.

So, for example, one of the things that does not exist in the industry, partly because we're not at scale and we don't have the experience, is a rating system that allows -- makes it easier for investors who don't already know us. A banker who already knows, you know -- you know, many of you do, but -- or, Susan, you work with a loan fund in New Jersey.

You know them well, but, in fact, an investor who wants to invest, it's very hard. We make it as hard as we possibly can for investors to put their money with us, so we've got to get better at that. And so my organization is actually working on creating and implementing a rating system, just on CDFIs.

We'd much rather have it be a mainstream rating system, but we're too small and don't have the credit history, at least that's what they tell us, to really be able to make that happen.

And we need to think differently about how -- about our partnerships with mainstream financial institutions. I think that relationship has grown significantly over the last 10 years or so, groups like Buzz's group LISK has really done some innovative things and finding ways to use low-income housing tax credit, new markets tax credit.

But we need to continue to expand our thinking, and it's more a shift on the part of CDFIs to sort of make that paradigm shift to understand that we're not -- you know, we're not beneficiaries of large S, but we're business partners in trying to create sustainable economic development and community development.

So I think that's the end of my presentation. I hope that's helpful. I talk fast, I know.

Governor Gramlich, if you have questions, I'm happy to try and answer them.

GOVERNOR GRAMLICH: Yes. The question is what you do in the way of evaluation. And, I mean, there is various kinds of public money that goes into this. I guess there's tax credits, there's some -- the subsidy from the --

VICE CHAIR PINSKY: Direct appropriation, right.

GOVERNOR GRAMLICH: -- from the Treasury, and arguably you benefit from the CRA investment test, and so forth. If you are ever asked to justify those subsidies on the basis of what the CDFIs have done for real community development, how would you go about answering that?

VICE CHAIR PINSKY: Well, I'm happy to ask all of my CDFI partners around the table to help me with this one, but I think we've tried to look at it in a number of ways, and it's for different audiences. So for the CDFI Fund, to try and justify that, we can document that every dollar that the federal government puts into -- in the form of subsidy puts into a CDFI results in about $22 to $24 in new money invested into communities.

We talked -- somewhere we talked about the magic number in Congress is $17 for every $1, right? I mean, we can document it's about roughly $24.

We have -- one of the challenges we face, and perhaps it's similar to what bankers face when they have different expectations from regulators and investors and everything, is that we have foundations, for example, who might lend us money as well as grant us money, who have a set of expectations around -- broadly defined in terms of impact.

And I think we haven't done that as well as we should have. I think that we had an opportunity in the late '90s to really take that bull by the horns and really define it well, and I don't think we've done that well enough. And now we're playing catch up, and that's a bad thing to do with one of your primary sources of funding, right?

We have always looked at it in terms of outputs. There are some emerging models that really try and look at it in terms of -- there have been some indepth studies that have really looked at it in terms of changes in tax revenue and, you know, looked at sort of social capital issues, and things like that. So it has been a little all over the place.

Then we have sort of a third main constituency, which are bank investors, who are looking at it in different ways. Every bank is different, as you know. Some of them are looking at it in terms of what the yield on the investment is, and there is clearly -- as investing in CDFIs has grown as a business within the banking industry, they have gone from -- it has taken on a kind of a sense of -- materiality in a sense.

And it is no longer -- banks who are willing to do things well below market are no longer willing to, and I don't think it's because -- I mean, I think the only motivation is suddenly they have perhaps, in large banks, hundreds of millions of dollars invested in CDFIs, and they can't -- they can no longer overlook 200 lost basis points. So that has changed in some way, so they are looking at that.

But they are also looking at it in terms of their own business interests. They're looking at: what is this creating in terms of economic development within their footprint, within their market, what opportunities is it creating for them, and they also clearly look at it in terms of what CRA value does it have with us.

For example, some years ago we created a -- the equity equivalent investment, which is an equity-like investment, with Citigroup. That was worth a lot to them in terms of CRA value, but they don't do -- they actually don't do equity equivalent investments anymore. A lot of other banks do, so -- I don't know if that's an answer to your question, but it's an attempt.

Agnes?

CHAIR SCANLAN: Could you just expound upon the last point on the slide before which says, "Need to involve mainstream financial institutions as partners." I'm about four years out of -- out of touch with CDFI, and what are some of the thoughts for future collaborations?

VICE CHAIR PINSKY: Well, I think -- you know, I referred earlier to sort of this major transformation. I think that having started out defining what CDFIs are, I think the definition of what a CDFI is -- is going to become less important as we emerge into sort of a more -- what I think of as a more integrated community development finance system, where there are certain things that banks do much better than CDFIs could ever do, but there are things that CDFIs do better than banks can do.

And we need to sort of figure out how to bring those sort of core competencies to the table and figure out how to construct a system around that that has some efficiency and has scalability, rather than what we do now which is say, "If you give us some money, we'll figure out how to lend it some way."

So, for example, one of the things -- one area that leads itself well -- that lends itself well to scale that we don't do with an eye towards scale now is aggregate capital, right? We do that very inefficiently.

Every CDFI spends a lot of time and a lot of energy talking to all of you, and a lot of you bankers have been saying, you know, "Can we get a little bit of capital?" when, in fact, clearly aggregating capital is something, if you can do it at scale and have an efficient distribution system, it saves you a lot of money and makes it possible to do things not only at a greater scale but hopefully reaching more places.

So, Agnes, I don't know if that answers your question, but that's just one example.

Buzz, please.

MR. ROBERTS: Just to add on to your response to Governor Gramlich, this is some -- part of this depends on what kind of CDFI you are.

VICE CHAIR PINSKY: Yes.

MR. ROBERTS: Right? Because you're doing different kinds of things. And some of them are really basic, like, when you borrow money, are you able to repay it all the time? Or when you lend money, how much good are you able to collect? That kind of basic stuff.

Some of it then goes to the next kinds of levels, like, and what kind of leveraged outputs are being generated in communities? And what's the performance of those activities? Are they performing well or performing poorly?

Beyond that, though, get -- it starts to get very interesting, and we've spent a lot of time looking at -- since our particular business is to finance community development corporations, we have a lot of metrics for the capacity of the community development corporations, along nine dimensions, scales, and such.

And so we try to track that, because that's part of -- our mission is not just purely financial, but it's also organizational-developmental. And then, systems change because what we're trying to do is create effective systems for supporting community development locally. So, again, there are a lot of metrics that are developed around those local systems.

Beyond that, we've had the fortune of having some funds come through the federal government. And along with that over the last year have become -- have come major studies by GAO and OMB. And so they have looked at what we do in a pretty thorough and multidimensional way. And I could spend some time talking about that, but -- Elsie?

MS. MEEKS: Well, I've been in the CDFI industry about as long as -- longer than Mark, actually, one of the second set of board members for what was then -- NCCA used to be National Association of Community Development Loan Funds.

And, you know, we've had to talk about scale and, you know, how we're going to reach scale and all of these things to get, you know, especially the banking industry's attention, but really anyone's attention. And on the other hand, I mean, this isn't some cute strategy. I mean, our communities lacked access to capital.

We couldn't get credit in our communities, and that's why CDFI started. I mean, I don't have to tell you all of that, but -- and, you know, when we talk about impact -- I mean, I think the fact that we can provide credit in our communities and places where banks haven't been able to do it is impact plenty, and have performing loans and have houses financed, and have businesses started up.

I mean, Pine Ridge, the -- you know, the reservations are horribly difficult for banks to lend in, because of the inability to secure land and all of those things. And CDFIs on the ground have provided the steps towards doing that, have come up with the solutions themselves. I mean, it's still difficult. I mean, we have mortgage lenders that want to lend at Pine Ridge and other reservations, but they can't do it. But we've been able to do it.

And so, you know, how we continue in this environment is, you know, a question we're all going to have to grapple with. But, you know, economists like to know impact. You know, I always say, well, what -- you know, how can you really measure the impact of the tax cut?

And I think, you know, the fact that we're doing what we said we would do, where we're making loans in places that people haven't -- conventional lenders haven't been able to do it, you know, to me is impact enough.

VICE CHAIR PINSKY: Well, thank you for the opportunity to talk a little bit about this. The documents I passed around, if anybody wants to take a copy, feel free to. If you don't, leave them on the table. You don't have to hand them back to me. But if you want one and you can't get one, just give me a card. I'd be glad to share one with you.

Thank you.

CHAIR SCANLAN: Thank you.

(Applause.)

At this time, let's move into the Committee Reports, and have each of the chairs of the four committees talk about the discussions that occurred over the last couple of days as well as the plans for future topics.

And if we can, let's start with you, Janie.

MS. BARRERA: Okay. Good transition, because one of our items of discussion yesterday was the CDFI. So the Community Affairs and Housing Committee specifically talked about the issue of funding and long-term sustainability of CDFIs. And we invited Lee Foley, a partner with Moss, McGhee, Bradley & Foley, who is a long-time advocate of CDFIs and also part of a -- is in charge or runs a few community banks.

And as he gave us the overview, the down side was he talked about cuts. And after he gave us the down side, the up side was there's going to be cuts. I mean, you can't do anything about that. But the up side is the funds that are still available are going to go to efficient organizations and regional organizations and organizations that can really create that impact. And so I think as CDFIs, you know, we have to take lessons learned and see what we can do with that information.

And then we talked about the relationship that the financial institutions can play into fostering this. And because the bottom line was -- from the bankers in the room was that they don't want to see CDFIs go away. They see the importance of CDFIs, and a lot of time and money and talent has gone into this.

So one of the ideas then came, well, let's go and look at the Community Affairs Offices in the different districts, see what they are doing at the fed level, and then what can we learn from the activities? Specifically, there was an activity in -- at the Fed in San Francisco, where they convened a workshop to address these issues.

And so, you know, what else could be done at the other districts to convene such workshops? And so we have homework. We are all going back to our own districts to find out what is happening, what are the emphases being placed on those districts in terms of community affairs, and then at our June meeting we will discuss those items and then what are going to be the next steps.

Another item was the HMDA Regulation C. We had a staff briefing from Kathleen Ryan on the background and overview of OMB's changes to MSAs, and corresponding changes to Regulation C and the impact on low- to moderate-income designations. So at the March meeting we plan to receive a presentation from the staff on the fiscal impact tool model.

This is something that has been put together pretty recently. It is an automated system that analyzes the potential impact of economic development projects for local areas, and so we're looking forward to that. Another item will be -- for discussion will be the OCC preemption. And, lastly, we will be discussing -- we will have a discussion on the Treasury's new interagencies initiatives.

CHAIR SCANLAN: Thank you, Janie.

Could we move to you, Ken, to speak about the Depository and Delivery Systems Committee.

MR. BORDELON: Sure. Our Depository and Delivery Systems Committee met on three major items, the first being Check 21, and we had Mr. Jack Walton from the bank's Division of Banking Supervision and Regulation. He did a very good job of taking that huge document and giving us a 30-minute briefing on all of the implications.

Pretty much the comment period on the reg closed on March 12th. He reported receiving 143 comments to date, numerous concerns from the consumer groups about the impact on Check 21 to consumers. From the industry perspective, we think that there is a pent-up demand because the technology is now more reliable and more affordable.

In fact, we circulated an article from the American Banker that First Tennessee was rolling out a product to their merchants where the checks are going to be captured at the retail level, at the merchant level. So basically what we said is float is going away. Float will be going away to zero pretty soon, and we feel that's going to have significant impact to the consumers.

Adrian did pass around a consumer education brochure, and we all agreed that there is a lot of work to be done to alert consumers about the impact of Check 21.

We did have some discussions about the confusion now with some of the NACHA rules dealing with ARC transactions that are already causing consumer complaints and how those were related to Check 21. So that will be kind of a carry-on discussion for the June meeting.

The second item we discussed was basically Reg E items dealing with recurring transactions on telephone solicitations on debit cards, the question there being: is written authorization required? And the other question being: is a tape recorded conversation basically an authorization under the e-Sign Act? And basically no real consensus there, except that we might be stuck with that interpretation of the e-Sign Act and pretty much left it at that.

The final discussion item -- and this was dealing with the debit card study that the Board has placed on the agenda by Congress. This was a study mandated to investigate the implementation of fees for debit card usage for PIN-based debits.

And interesting -- in most of the conversation that our committee had, our friends at Wal-mart were mentioned a lot.

(Laughter.)

And this conversation naturally, dealing with a debit card study, got to, how do you disclose the fee to the consumer, and at what point those disclosures should be either on the account level or at the merchant level. And we kicked around the idea of pretty much the generic disclosure being implemented now when consumers are using a foreign ATM, and they're getting a generic disclosure that your financial institution may impose a fee -- as a possible solution for taking a look at that.

The staff reported that the Federal Register notices to announce the study should be going out next month, so that is also a carryover item for the June meeting.

So for the June meeting, for our dull committee -- it started out dull --

(Laughter.)

-- we do have the carryover of the debit card study, we have the FACT Act and how it relates to ID theft, the continued conversation on the Check 21 and ACHARC issues -- that's a carryover -- and we might have time to take a look at Reg D, the transfer limitations, six transfers per month.

CHAIR SCANLAN: Thank you.

Buzz, if you could tell us about the discussions and plans for the future in the Compliance and Community Reinvestment Committee, please.

MR. ROBERTS: Sure. We spent most of our time talking about the proposed CRA rule and the GAO study on predatory lending, which have been discussed at great length here today, so I won't go into more on that.

In terms of the future, the committee expressed interest in looking a little bit more at the circumstances under which the Fed monitors CRA agreements.

CHAIR SCANLAN: Thank you.

And, Pat, if you could talk about the Consumer Credit Committee.

MS. McCOY: Yes. In our committee meeting yesterday, we discussed three topics, two of which have been discussed today before the members. And the first is the clear and conspicuous proposed rule. The second are certain implications of the GAO report on predatory lending. We had a very brief discussion on the proposal to expand the Board's examination powers.

The third topic is one that we did not discuss today, and that is the Board's responsibility to develop implementing regulations under the FACT Act, which amended the Fair Credit Reporting Act.

We will continue to discuss FACT Act issues on a rolling basis, but for this first discussion we looked at three issues, two of which require a final rule by June 4th. One was the use of medical information, the second was the negative information notice, and the third was the risk-based pricing notice.

On medical information, I think that was a very useful discussion, because we are able to discuss in detail narrow situations in which the fact that debts are medical in nature would need to be known, very, very narrow situations in which a medical condition would need to be identified. And also, the use of disability income or information about disability income.

On the negative information notice, I think that we were all struck by how little discussion the Board has. We reviewed some model language for that notice.

And then, finally, on risk-based pricing, that was a very vigorous discussion, and I think it's fair to say that we realize this is a complicated area. We will probably be returning to a fuller discussion of how to do that notice in June.

And that takes me to our June topics. We will continue with the FACT Act. We will be looking at affiliate-sharing, probably again at the risk-based pricing notice, the disposal rule.

A second topic -- there is great interest among the committee members in returning to another aspect of the GAO report on predatory lending, which is the securitization process and due diligence procedures for the securitization of subprime home mortgages.

Our focus in having that discussion would be what relevance does that have to Fed oversight of either financial institutions who act as securitizers or financial institutions who buy from subprime securitized issues.

A third topic -- staff has asked us to look at the frequency and incidence of debt cancellation and suspension contracts, to get a better understanding of how these work.

And then, finally, if we have time, we may have a brief discussion on the topic of balance protection -- a perennial favorite.

(Laughter.)

Thank you.

CHAIR SCANLAN: Thank you.

As we begin to adjourn for this first meeting of the year, just a couple of announcements and reminders. Again, please stay in the room, the Council members and the Governors, for the photograph that will occur at 1:00.

Lunch is just down the hall to the left in Dining Room L. We'll have lunch right after the photograph.

Also, if any of the members of the Council wish to leave their personal items in this room during lunch, please leave it over in the public area as opposed to the area we're sitting in right now. This area is going to be taken down and put together for another meeting. It is going to be broken down, so please leave your personal items over in the public area, where the public has sat during the course of the meeting today.

I'd like to thank all of the Council members for all of your participation over the last couple of days. Also, I'd like to thank the Governors for your participation -- Governor Gramlich, Governor Bies, and Governor Bernanke.

Also, we really must thank the Fed staff for your support, and particularly Ann Bistay and Tina Featherstone for all of the planning and the work that you did for this meeting.

Thank you all, very much.

And, again, farewell and good luck to you, Dolores.

(Applause.)

(Whereupon, at 12:54 p.m., the proceedings in the foregoing matter were adjourned.)