TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING
THURSDAY, JUNE 24, 2004

The Consumer Advisory Council met at the offices of the Board of Governors of the Federal Reserve System, in Dining Room E in the Martin Building at 20th and C Streets, N.W., Washington, D.C., at 9:00 a.m., Agnes Bundy Scanlan, Chair, presiding.

Members present:
Agnes Bundy Scanlan, Chair
Mark Pinsky, Vice Chair
Janie Barrera
Kenneth P. Bordelon
Sheila Canavan
Robin Coffey
Anne Diedrick
Dan Dixon
Hattie B. Dorsey
Thomas P. FitzGibbon
James Garner
R. Charles Gatson
Larry Hawkins
W. James King
Ruhi Maker
Elsie Meeks
Bruce B. Morgan
Debra S. 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:
Sandra Braunstein, Director, Division of Consumer and Community Affairs
Roger Ferguson, Vice Chair, Board of Governors
Edward Gramlich, member, Board of Governors
Susan Bies, member, Board of Governors

C O N T E N T S

P R O C E E D I N G S

9:00 a.m.

CHAIR SCANLAN: Good morning. Welcome to the Thursday Public Meeting of the Consumer Advisory Council. My name is Agnes Bundy Scanlan. And I'm Chair of the Council.

I'd like to recognize and welcome Vice Chair Ferguson as well as Governor Bies, who will be both here with us this morning, Governor Gramlich, the Chair of this group, will be with us later this morning.

We have a full agenda. We spent a lot of time yesterday in committee meetings having robust discussions on numerous topics.

You see from the agenda we are going to start this morning with one of our members providing us information about the relevance of CRA in rural America. Hubert Van Tol will be talking with us about the relevance of CRA in rural America.

Then we're going to go into the topic of economic growth in Regulatory Paperwork Reduction Act of 1996.

Then have a discussion of foreign bank remittances and access to financial services by new immigrants.

After that, we'll have a break and go into Courtesy Overdraft Protection. We had a very lively discussion about that yesterday. Actually all of our discussions are lively.

And then we'll talk about the Community Reinvestment Act and followed by Committee reports.

We'll have lunch at one o'clock. And for those of you who have not had a chance as members to sign up for the taxicab rides to the airport or whatnot, please do so during the breaks so that the staff can be prepared to ensure that we have rides.

With that, we will move right into the Members Forum. And Hubert will speak with us right now.

MEMBER VAN TOL: Thank you, Agnes.

My microphone, I think I forgot to do one thing I was told to do, turn it on. Is it working now?

PARTICIPANT: Barely.

MEMBER VAN TOL: Everyone can hear me? Good.

Okay, if you want to follow along with the presentation, it's this blue bar thing that you'll find among your materials. I'm about as technologically adept as the next to last person, so this is a very basic PowerPoint presentation.

But I did appreciate the opportunity to come and talk with you today about an issue that's quite near and dear to my heart. I grew up on a farm in Iowa and spent a number of years in cities. And have now made my way back to rural Wisconsin.

My colleague and I, let's see if I got this right, my colleague and I, Mark Camp, founded Fairness in Rural Lending in the year 2000. We were -- had done -- each had done a number of -- had done work in a number of arenas for many years.

I began Community Reinvestment Act work in 1985 in Memphis. But as rural folks, we were trying to grapple with how do you make this movement relevant to rural communities because in so many ways, it isn't. So we created Fairness in Rural Lending.

Our first thought was to call ourselves a think tank. But those of you who know the rural Midwest, realized that that would be the quickest way for us to draw the ridicule and scorn of our neighbors.

(Laughter.)

MEMBER VAN TOL: So then we almost settled for being a skeptic tank.

(Laughter.)

MEMBER VAN TOL: But we also thought the better of that and became a simple policy advocacy and research organization.

I'd like to sketch out just a few of the ways that in my view CRA, HMDA, the fair lending laws generally are less relevant to rural areas. We've tried to do some practical work from time to time. We helped move an anti-predatory lending bill through the Wisconsin legislature that our Governor just signed a couple of months ago.

And we've done a number of reports for agencies and for other nonprofit organizations about the extent of sub-prime lending in rural communities.

I want to emphasize that in talking about rural areas, I'm speaking from the perspective of upper rural Midwest, which I think is quite a different creature than much of rural America, certainly Appalachia, the rural southeast, Indian Country, the southwest, have a completely separate set of problems than the rural midwest with its strong family farm background would have.

You'd see a lot less of some things in those areas than you'd see in the midwest and vice versa. If any of you have ever seen the map of the country that USDA has prepared of financial institutions per county, you'll realize that in those other rural areas, you often see counties with two or less financial institutions.

But that is not the case in the upper Midwest. We're awash in community banks. Within an hour's drive of my home, I can get to 26 banks with assets less than 250 million within an hour, in towns smaller than 5,000 people. So at a time when most of the small rural retail institutions are fighting against the Wal-Mart-ization of rural America, the community banks are still doing really quite well.

Those of you who are real urbanites probably think that by rural we mean places where farmers live but that's becoming less and less the case. Even though there are farmers in the county I live in, only eight percent of the population lists farming as their primary occupation on the census, 2000 census.

You know there's much more light manufacturing and education and government and all of those -- medical care -- all of those kind of employees, employers are a much bigger part of our picture actually.

And then of those who are farming, in surveys roughly 50 percent of them often will say in surveys that they get income from areas other than farming.

So lest I go too far astray, you're probably wondering what fitting a round peg means -- don't ask me. Somehow it was fitting a square peg in a round hole is how this started out. And then it went completely astray.

(Laughter.)

MEMBER VAN TOL: But I remember as a child always puzzling over that. I grew up on a pig farm and I always puzzled over that phrase fitting a square peg in a round hole. I wondered why somebody would want to do that.

(Laughter.)

MEMBER VAN TOL: Later my vocabulary and pronunciation did get a little better.

One of the first issues that you confront when looking at rural areas is HMDA data inadequacies. Depository of the rule for HMDA reporting for depository institutions is that those larger than 33 million in assets that have an office or branch in an MSA and originate at least one home purchase or refinance loan are required to report HMDA data.

This really limits the usefulness of HMDA data. Of those factors, it's really the one having an office or a branch in an MSA that knocks out the vast majority of institutions rather than the 33 million dollar limit which really is, very few institutions are covered by that.

But when we were -- one of the issues that came to our attention early on was if you strictly look at HMDA data, it looks like subprime lending is taking over rural America. And this is partly a distortion of the data.

So one of our first projects for the Iowa Finance Authority was to actually go into seven counties in Iowa, and we've since done this is Wisconsin counties as well, and look at the actual mortgage records and try to compare them against the HMDA records. It's the, you know, what the incongruities were.

So using those -- as more and more counties digitize their records, that's becoming increasingly an easy thing to do for people with, you know, minimal computer skills.

In the years that we've looked at HMDA data, the raw number of HMDA loans in an MSA equals about 80 percent of the loans that will show up in the mortgage records. And this is mostly a factor of the home equity loans, you know, have this ambiguous status in HMDA and a lot of them will show up in the mortgage records but not in HMDA.

But it's roughly at about that level, that about 80 percent of the records that would show at the mortgage record level will show up in HMDA. But when you look at the rural counties, the number gets much lower. And the further you get away from an MSA, the lower and lower that number gets.

In one county, we -- just measuring these raw numbers which, you know, it is really a very inadequate way of looking at it but it was the way we were capable of doing, 15 percent of the mortgage lending documents were accounted for by HMDA.

So in looking over seven counties in Iowa and 14 in Wisconsin, it's our estimate that HMDA accounts for about 25 to 50 percent of the lending that actually occurs in most rural counties in the upper Midwest. So you can see that it -- it's a very poor tool to use for deciding what's actually happening out there.

Now for those of you who have better things to do than think about HMDA, just so you know the other rule about HMDA is that for non-depository institutions, you have to be a for-profit institution, and your home and purchase -- home purchase -- well, what did I do -- well, something is happening here. What it is isn't exactly clear.

That's the very last one. Okay. Well, that's the first one.

While Tommy is doing that -- let me go ahead.

For non-depository institutions, the rules are that you have to be a for-profit institution; and your home purchase and refinance loans have to equal ten percent of all originations or 25 million dollars; and you have had to have had an office or branch in an MSA on December 31st of the previous year or five applications or originations of home purchase loans or refinance loans in an MSA; and --

The parent company has assets of ten million or more or originates more than 100 home purchase or refinance loans in preceding years.

So that's -- because of the MSA requirement for non-depository institutions, we also don't catch many of those in the HMDA data.

Previously, some very large finance companies avoid being counted for HMDA because of the way that rule was written. That has been tightened up and so now the larger finance companies, at least, are showing up on the HMDA data.

Okay, thank you, Vanna.

(Laughter.)

MEMBER VAN TOL: Besides the HMDA data in adequacies, there are the CRA data inadequacies as well because as you know, the only institutions that are required to make -- to report the CRA data, which includes small business, farm, and community development lending, are large institutions, those 250 million in assets or larger.

So it's kind of one of the ironic facts of this issue that even though farm loans are specifically mentioned as being something that we're trying to collect, most of the institutions that provide or the institutions that provide a great deal of the farm lending are exempt from collecting data about it.

And this shows as well in -- the CRA data is more complex in how it's collected for, for counties of 100,000 people or more. So it becomes a difficult body of information to apply usefully for farm lending. That doesn't mean it's not very useful for people who are collecting it for small business and community development lending purposes.

Small bank rules are another part of the problem that we face. Small banks, as you know, get the streamlined CRA exam, which has a lending test but no service or investment tests. I think much of this we actually went over in one of our committees yesterday so we're repeating some ground.

The current regulation before the financial institutions is to raise that threshold from 250 million to 500 million. I think in the initial thought of that, the regulatory agencies were just thinking in broad numbers of what is the asset base of the depository institutions in the country. And this is actually a limited portion of that overall deposit base.

But from a rural person's perspective, the CRA is not about overall investment, it's about community investment that has to be done community by community.

Just to give you an example of how this change in the threshold effects different areas differently, in Wisconsin, we have 72 counties, 70 of those have a large bank presence in them, either a branch deposit office, et cetera. In Iowa, Iowa has 100 counties and currently 80 of those have a large branch presence of some sort.

If the threshold gets raised to 500 million, Wisconsin will continue to have a large bank presence in 70 of 72 counties because of the nature of the branching structure of the institutions that we have in our state. But in Iowa, another nine counties will have a large bank presence knocked out of them. So there will be 29 counties that won't have a large bank presence at all if that threshold is raised.

The other part of the small bank rules that I think most of you know is that with Gramm-Leach-Bliley, the frequency of exams was lessened considerably. Whereas typically a large bank will have a CRA exam every two or three years, small banks, if they get a satisfactory rating, have 48-month intervals. And if they have an outstanding rating, get 60-month intervals now.

And the way the large bank definition is that you have to have 250 million in assets for two previous December 31s before you become a large bank. So there is a considerable lag in the time period between when a growing small bank becomes a large bank and actually starts being reviewed, having a performance evaluation that's a large bank evaluation.

And that slowness is a little more prevalent in one agency, who will remain unnamed but which isn't the Federal Reserve, than it is in others because that agency seems to schedule a small bank -- a last small bank exam for in that time period when a bank is just near to becoming a large bank.

Another problem that we have is just with how definitions are done within the Community Reinvestment Act. Much of the Community Reinvestment Act centers around geographies, low-moderate income geographies. And this is an area in which the median income of the smaller area, the census tract, is 80 percent less of the larger area.

So typically in rural areas, you'll have a much smaller spread between the lowest income census tract and the upper income census tract. A typical urban area, you might have census tracts that range from 20 percent of median income to 200 percent or, you know, something in that range. Whereas in the county I live in, the range is actually from 80 percent to 114 percent. So it's a much narrower range.

And the practical effect of this is that there are a lot fewer LMI geographies.

A second part of the problem is that for rural areas, the measurement that is used is the non-metro median income. So for a census tract in my county to be LMI, it's actually measured against a lower standard than if it were measured against the statewide median income.

And in Wisconsin, the non-metro median income is about 44,000. The statewide median income is about 51,000. And the metro median income is about 57,000. So you see that makes a considerable difference in the number of geographies that would fit into the LMI characterization.

And, you know, I don't know the exact history of why all that occurred. I'm sure people were thinking that, you know, we should be compared against comparable groups of people and the cost of living is, perhaps, lower in rural areas.

But the practical effect of it is that if we -- for instance if in my county, we use the nine census tracts, one of them now is LMI and the rest of them are all middle income even though my county's median income is 83 percent of the state's median income overall.

And we're a fairly poor county. But there are no LMI tracts -- or there's one

LMI tract in it. If we use the state median income range, it would be three LMI and six middle income tracts.

So the rural pattern then is that you have many more borrowers who are LMI income than who live in LMI tracts.

The CRA exams compensate for this somewhat by taking into account that income on the lending test but where that really creates a problem is in the investment test for the larger banks because revitalizing or stabilizing LMI geographies is one of the focuses of community development lending and investment on the investment tests.

So it's easier to focus on low-income housing because there, you know, you can focus on providing services to the borrowers who are low income.

In -- you've all heard me go on and on many times about assessment areas and I could do that again. But just to focus on the problems in rural areas, with small banks, the assessment areas are usually on target and the PEs or the evaluations, the CRA evaluations follow that fairly closely.

In the large regional banks with branches, sometimes the assessment areas will miss the most rural areas but the most important problem is for those regional, large banks, is that when the examiners come in and do the evaluations, they will often do what's called the limited -- they'll do a full review of the most populated and, I guess, the most populated or the assessment areas that have the biggest percentage of the deposits of the institution and then the rural areas often get what's called the limited scope evaluation, which means that a lot less attention is paid to the rural areas.

And then with the largest national banks without local retail outlets, you very seldom have assessment areas that cover us at all because there are no retail outlets in our counties. The retail outlets that are there, of the largest institutions, are often those of their sub-prime affiliates.

And I told Jim I'd pick on him just a little but just to give you an example in my county, which I think is not typical of a southeastern county or a southwestern county because we have a credit union, four banks, and a CitiFinancial office.

And in terms of their marketing presence, I would say in terms of direct marketing, CitiFinancial does much more than the local institutions do and I think that's part of the looming concern that some of us have is that the largest institutions will focus their sub-prime attentions on rural areas and we won’t have access to their prime products.

So in that case, you know, CitiFinancial -- or CitiGroup can do, you know, very good work in New York City and the places where it has assessment areas. It has no assessment area in our county. So we have within the scope of CRA, we really have nothing to say about their activity in our county even though it is a very considerable presence.

And I could say the same thing about HSBC and Household, Beneficial. Chase is the largest rural mortgage lender in the State of Wisconsin, which is a very good thing, but has no CRA requirements for the investment and service test because there is no assessment area.

Final issue, you all hear -- I’ve heard about lending disparities and when people are talking about that, they’re usually talking about racial disparities. The difference in loan denials to African-Americans, Latinos, Native Americans is much higher than for whites.

But there’s also that lending disparity between metropolitan and rural borrowers, at least within the universe of the HMDA reporters. You know because of the problems with the data, I don’t know what adding all those small lenders into the mix would do but in the universe of HMDA reporters, urban origination rates are higher than rural origination rates, especially -- I know that’s true in Wisconsin but I haven’t, you know, looked at other states.

But in Wisconsin, the interesting part that I found to this, even though the data may mean nothing, but that credit union origination rates are the same in urban areas and rural areas. In the Wisconsin-based banks, the disparity is a little bit. In the banks that are based outside of the state, the disparity becomes much greater.

And these disparities are across all income levels and true in both home purchasing and refinance loans.

So we’re often told that the solution that rural communities don’t have a CRA problem because we’re served by community banks and community banks wouldn’t be in business if they didn’t serve their communities. And I think when you have a situation like the rural Midwest where there’s a tremendous amount of competition, there’s a good deal of substance to that argument.

But I can say that -- well, just to look at one objective measure, if you go back and look who the agencies have given needs to improve or substantial noncompliant CRA ratings in the past five years, all you will find is small banks.

And we can argue about why that happens. And there might be many reasons for that. But clearly in the regulators' eyes, the small banks aren't always doing a good job in their communities.

And if you look at just one of the criteria that they're judged on the loan-to-deposit ratios, I know in Iowa and Wisconsin, you'll see loan-to-deposit ratios that range from 110 percent maybe at the highest or a little over 100 percent for a small bank down to 35, 40 percent.

So there are communities in which not very much of the deposits are making it out into the communities.

And then the quality of community involvement of community bankers varies greatly. There are the people who fully understand that their success depends on the community's success. And they work with the community.

And then there are the people who are still in the pre-capitalist stage. They're, you know, medieval, the lords of the castle. And they give their loans to their vassals. And if a serf who is particularly obescient comes along, they might get a loan as well. But we do have people like that in rural America.

Access to government-backed products in secondary markets vary significantly as well. Some institutions will provide those kinds of things. Others won't.

And then I would say that again, I guess, where I started, that in rural America, there's significant variations. You can't make claims that what happens in the rural Midwest is necessarily true in the rural southwest or the rural southeast.

Thank you very much.

CHAIR SCANLAN: Thank you very much, Hubert.

(Applause.)

CHAIR SCANLAN: Are there any questions for Hubert?

MEMBER FITZGIBBON: I just wanted a clarification. When you talk about origination rates, you were talking about interest rates, were you not? Not the percentage of loans that were originated?

MEMBER VAN TOL: No, the percentage of loans that were originated.

MEMBER FITZGIBBON: Oh, it is?

MEMBER VAN TOL: Yes.

MEMBER FITZGIBBON: Not interest rates?

MEMBER VAN TOL: Yes.

MEMBER FITZGIBBON: So it is the -- it is the pull-through rate --

MEMBER VAN TOL: Right.

MEMBER FITZGIBBON: -- or the number of loans that are approved versus those that are turned down?

MEMBER VAN TOL: Right.

MEMBER FITZGIBBON: Okay, thanks.

MEMBER VAN TOL: And we're looking very much ahead to the HMDA data for next year which will help us determine if the pricing part of it is true as well.

MEMBER FITZGIBBON: Okay. Thank you.

MEMBER VAN TOL: Ken, I gave Ken that plug. Ken told me he was going to ask me how many pecks were in a bushel. But I guess he decided not to.

(Laughter.)

PARTICIPANT: I don't think he knew the answer.

CHAIR SCANLAN: Thank you again.

Now we're going to turn our discussion to several of the topics for today's meeting. The first one is economic growth in Regulatory Paperwork Reduction Act of 1996. And to lead that discussion, Buzz Roberts will begin.

MEMBER ROBERTS: Well, thank you. Thank you very much, Agnes.

We talked about three topics in particular within the committee yesterday, TILA recision, home mortgage disclosure, and CRA Sunshine. And I think to start with the easiest of those, let's start with CRA Sunshine. And maybe Anne would like to kick us off.

MEMBER DIEDRICK: Sure. I'm happy to.

This was pretty interesting and pretty easy. As Buzz mentioned, during our discussions, the Sunshine came up, the Sunshine Rule came up.

And Sunshine clearly has created a data collection reporting burden for banks with absolutely no useful purpose that we could see. And, in fact, our committee unanimously wanted to say we hope the Fed would urge Congress to repeal Sunshine because it's useless and meaningless.

MEMBER ROBERTS: Would anybody like to --

(Laughter.)

MEMBER ROBERTS: -- argue with that?

(No response.)

MEMBER ROBERTS: Well, having disposed of that --

(Laughter.)

MEMBER ROBERTS: -- let's turn to something a little bit more controversial, the TILA recision rules. And Diane, would you explain to us what the TILA recision rules are and whether you think they are necessary?

MEMBER THOMPSON: Well, of course I think they're necessary. That's how I make my living.

But more seriously, the TILA recision rules provide that in case where a homeowner refinances their home, they have a three-day period from the time of the loan closing before the funds are dispersed. And during that period of time, they can cancel the loan transaction without incurring any costs.

This is a very important right for most consumers. Most Americans, and particularly the low-income Americans, their home is their most significant asset, sometimes their only asset, their only wealth.

And so the right of recision gives people a chance to think about is this a loan they really want. In addition, there is a three-year extended right of recision in cases where the right of recision was never properly granted or the proper disclosures weren't made initially.

And this is particularly important in the case of representing homeowners who have predatory loans. It is almost certainly the only statutory relief available to most homeowners who have been refinanced in shady or unscrupulous transactions.

And without the right of recision, much of my ability to preserve the wealth of the low-income homeowners I see every day. And by extension, the wealth in their communities would evaporate. It's a very important right. We exercise it probably 25 times a year in my office alone on behalf of low-income homeowners.

And without that right, their ability to preserve their homes in the face of unscrupulous practices would simply evaporate.

We have not -- I have to say that I was genuinely puzzled by the comments of industry. There have been comments by industry that identify the right of recision as being particularly burdensome. And they represent they never see anybody exercise this right. And they think it's burdensome.

I would submit that it's the case of many consumer protection regulations. People find it burdensome until they come to the point where they need to exercise it. And particularly in an era now when mortgage loan documents come and stack several inches thick, it is very important for people who are putting their most important asset on the line to have an opportunity to review those documents, away from the pressure of a closing with other counsel, other family, other friends, and to think about whether or not the transaction that they're getting into really makes sense.

I think it's also important to note that under the EGRPRA project, what the board is mandated to do by statute is identify regulations that are outdated, unnecessary, or involve substantial compliance costs.

In none of the comments have I seen from lenders is there any argument that the right of recision, in fact, involves substantial compliance costs. And I can say certainly from my practice, that the right of recision is neither outdated nor unnecessary.

Thank you.

MEMBER ROBERTS: Who else would like to talk about that? Tom?

MEMBER FITZGIBBON: Thank you for that, Diane. It was extremely interesting. I think the hidden agenda here is not necessarily the cost of compliance from the originators' perspective. But it's the inherent liability that ensues with the acquisition of that loan either in a transaction that involves the purchase of that loan or, in the case of a merger or an acquisition, it may be the inherent liability going forward.

And having done six acquisitions of financial institutions in the last five years, I can tell you that the number one thing we look at in our due diligence review is to ensure that two things occurred. One was that the borrower was given the adequate disclosure. And that the disclosure was done in accordance with the regulations.

And I can tell you from probably four out of the six institutions is that either portfolios they acquired or portfolios that they originated is that there were issues relative to at least our view of the interpretation of the regulation.

And so I think that's probably the agenda that people are more concerned about than whether or not they comply in the origination process. There are a variety of different interpretations of things that people assume, if you will, that they are in good faith undertaking when, in fact, that that -- their compliance is wrong.

And so I think there is that inherent liability. It is extremely expensive. If the disclosures were not done properly and acquiring institutions are either acquiring the loan or acquiring the other institution, discovers an error, they have 30 days from the discovery of that to correct the error.

And so there are issues, I think, that are beyond sort of the origination cost. It is that inherent liability that comes subsequent to the origination?

MEMBER MAKER: Can I respond to that? Well, I'm glad that the real reason for getting rid of it is now on the table. The reality of this right of recision is used when, you know, public interest lawyers or other consumer advocates see a predatory loan and they want a tool and a mechanism to undo the abuse that's been done.

And to me, then, if this is the real reason that the lenders are opposed to it is it's a backdoor way of stripping one of the few tools, as Diane mentioned, that consumer advocates like us have when someone has been essentially defrauded and we use some of the technical tools that we have to redo those loans.

So I'm now even more strongly proposing that we not get rid of the right of recision because it's only going to be used, Tommy, when you have a bad loan. I mean you know clients don't come in and say oh, everything is perfect. Oh, this wasn't done right. Let's redo this.

I mean it's not used frivolously because it's time consuming. Consumer advocates, public interest lawyers have limited resources. And it's used really in the most egregious cases that we see where it exists. So where the three-year statute may not have expired or depending on how, you know, what the technical rules are that require its use or not.

MEMBER ROBERTS: I have Bruce, and Mark, and Diane.

MEMBER MORGAN: Buzz, one of the biggest misunderstandings about right of recision, I think, is that it's something that consumers really want.

I personally, as a community banker, have closed several hundred home loans in the last ten years. And it's the most misunderstood form that I have to ask the consumer to review and sign.

They don't understand it. They don't want it.

And I think what should be done is if there's any tinkering done with it under this regulatory relief, it should be to have a provision that would separate the type of transactions that the right of recision originally was meant to encompass.

If it's a simple refinance of a home loan, and the homeowner does not want to exercise the right of recision, if they have some reason that they need the funding before the three days has expired, give them the ability to opt out.

Now the right of recision that relates to a home remodeling contractor, a roofer, a siding contractor, that may have some very predatory lending terms, that type of transaction probably still needs the right of recision.

The right of recision, as it presently stands, is very anti-consumer. It's anti the consumer that doesn't want it. It's not something that is burdensome from the bank's standpoint except that we have to try to explain it. We have to do it. And, as Tommy said, if we don't do it right, then we do have some potential penalties.

But I think if you really look at it, on a lot of home refinance transactions, there are larger lenders that don't actually close the loan with the borrower. Now in my bank, as a community bank, we like to see the people that are borrowing money from us so we actually close it in our bank.

But it's not unusual to send these closing documents to a title company and after observing numerous title company closings, the type of people that actually close these loans with the title company make no attempt to explain to the consumer what they're signing. They just say sign here, sign here, sign here, sign here.

They may or may not read the right of recision. They do know that they can't get their funds for a period of days. They don't understand why typically if they haven't actually talked to the bank about the fact there's going to be a delay because it is a refinance transaction.

So in terms of easing the regulatory burden on this one factor, I only ask that the consumer advocates and attorneys that are speaking consider the consumer and try to distinguish the type of transaction.

And the one that is predatory versus the one that is a vanilla or ordinary home refinance where the consumer would not be harmed if they received their funds sooner than after the three-day right of recision period.

MEMBER ROBERTS: Okay.

Mark?

VICE CHAIR PINSKY: Thank you, Buzz.

The, you know, as a consumer, I very much want a right of recision just speaking as an individual. But, you know, and Bruce, I understand that. I think that most lenders want to handle this responsibly. I think that's right.

The problem is sort of like, you know, the guy who gets on the metro and, you know, asks somebody where to get off and the guy says oh sure, just, you know, watch me and get off at the stop before me. Right?

(Laughter.)

VICE CHAIR PINSKY: You know, the problem is you don't know sometimes until after the fact, you know, where the problem is in some ways.

And, you know, I think that, you know, from what Tommy said, Tommy if I understood you correctly, it's actually, you know, the burden of this is minimal if you do it right.

MEMBER FITZGIBBON: Correct.

VICE CHAIR PINSKY: It's significant if you do it wrong. Well it seems to me that's kind of how the regulation should -- or the rule should work, right?

MEMBER ROBERTS: Okay. Diane?

MEMBER THOMPSON: Yes, I just wanted to amplify a little bit on what Mark said which is that it works because there's a substantial penalty for doing it wrong.

And if you do it right, it's not a big deal. But there's a substantial penalty for doing it wrong and that's why Tommy and Bruce make sure to do it right.

And that's why there's due diligence. And that's why it's done right in many cases.

Without that substantial penalty, your compliance would drop off. Tommy would not be doing the kind of due diligence review on all of his acquisitions if there was not a substantial ongoing penalty for its having been done wrong in the first place.

The other thing I want to respond a little bit to what Bruce said about, you know, well maybe there's some transactions that we should exclude. Mark's right. You don't know until afterwards often which are the transactions that were a problem.

Consumers don't know going in -- I've never, never, in ten years, seen a homeowner who could unequivocally say I knew going into this loan that it was a bad loan. I've had a few people that said I had a few questions about it. Most of them thought they got a good deal at the time.

It's only afterwards when things start to go wrong, when things get unraveled, that they realize how bad the loan they have is. Even something that we talk about as a simple refinancing, a lot of the cases I see where people are threatened with losing their homes are simple refinancings.

Maybe the rate's gone up. Maybe they went from a 30-year fixed to a balloon note. Maybe they went to an adjustable-rate mortgage and it's getting adjusted upwards at a rate faster than their income is increasing.

There are lots of different factors that can go into refinancing that can make the refinancing not a simple refinancing or not necessarily a good deal for the homeowner.

And the fundamental issue about the right of recision is not that you can get out of any bad loan but that you get out of any bad loan where the disclosures weren't made correctly.

So if you make the disclosures correctly, you're fine. But if you don't, you've got a problem. And that's very important.

And it's very important to have the three days for the consumer to actually look at the disclosures because things change from what the estimates are to when they actually close. And to look at the right of recision and to look at what they actually got and to say is this really the loan I signed up for? Can I really do this? Is this what I really want?

And without that right, you increase the number of people who get into bad loans, loans they can't afford, and risk losing their homes.

The other very common misperception that I want to correct here is that we need an exception for people who need these funds. There's already an emergency waiver in the regulations.

So in any case of a bona fide personal emergency, somebody's faced with a tax sale or a foreclosure or a loss of their home through some other means and they need the funds immediately, there's already that waiver.

I don't know that there's a need, I can't imagine what the genuine need is to ask consumers to risk putting their home on the line without an adequate chance to review the disclosures other than a bona fide personal emergency and we already have that exception.

MEMBER ROBERTS: Okay. Let's go to Dan, Lori, Sheila, and then back to Tommy.

MEMBER DIXON: This sort of follows up on your last point, Diane. First of all, my company is not trying to make any change in the recision terms. Frankly, it hadn't occurred to us that would be an item to pursue under the review of EGRPRA.

But we do have a big interest in simplifying the mortgage closing process to deal with a lot of the issues that you just described. It didn't really have anything to do with the three-day recision.

It has to do with the fact that even if we perfectly comply with all of the regulatory requirements associated with mortgage originations, there is a very good chance the customer can't sort it out no matter how much time we might try and spend with them in a, you know, in a one on one.

We were very disappointed that the RESPA reform process couldn't get completed. That's not to say that what was proposed was perfect. But we certainly hope that there will be an opportunity sooner rather than later for the Federal Reserve to work with HUD and to come up with some ideas with industry and with consumers to try and simplify that whole process and reconcile the disclosures under Truth In Lending and RESPA.

I also, Bruce, would agree with you that there are certainly some consumers who are impatient and want to get their funding.

I respectfully have to disagree that title companies don't consistently do a good job. We do virtually all of our closings through title companies.

And our experience with that industry is, you know, it's not perfect. Banks aren't perfect and, you know, public interest attorneys aren't perfect. None of us are perfect.

PARTICIPANT: These two are.

MEMBER DIXON: But we think they generally do a good job.

MEMBER ROBERTS: Okay.

Lori?

MEMBER SWANSON: Thank you, Buzz.

I think if you look, the law allows the right of recision in a host of different areas, not just the mortgage area but a variety of different areas. And we do it for two reasons.

Typically we do it in areas where there is a potential for high pressure. And we do it in areas where the transactions are more complex than the ordinary transaction.

And so I think if you look not only at federal law but at state law, you're going to see areas like life insurance, for example, most state laws a ten-day right of recision for life insurance. Why is that? Life insurance is a complex transaction. It also has the potential for high pressure.

Do it for door-to-door sales under most state laws where if somebody comes to your house, they ring the doorbell, they sell you something, we allow a ten-day right of recision, in Minnesota anyway. And most states have laws like that. Why? The potential for high pressure.

I think if you look in the mortgage area, you have the refinancing area in the TILA area, you have the potential not only for high pressure situations but also you're dealing with one of these extraordinarily complex areas. I mean they can't -- for most consumers, a mortgage transaction is going to be the most difficult and most confusing consumer transaction that they participate in.

And then on top of the potential for high pressure and the complexity, you're also dealing with people's homes. And, you know, a home is the way that most American consumers develop a net worth. And so you're looking at potentially jeopardizing people's net worth.

And so what the right of recision does is it gives the consumer who is in a closing transaction, where a blizzard of paperwork is presented to them, they don't necessarily understand what's going on.

It gives them a right to get home, look at the paperwork, see if the term, if the deal that they signed on the dotted line for was the deal that was ultimately given to them. You know, were terms changed? Was the interest rate raised? Was the transaction altered in some way?

And it simply helps deal with the disparity of bargaining power by giving the consumer a right to undo a transaction which may not have been an appropriate transaction. Or it may not have been a transaction that they thought they were entering into.

And I would also add that in the predatory lending context, you know the complaints that we're seeing in Minnesota anyway in reference to predatory lending typically involve refinancings. It's a very typical area as opposed to original mortgage transactions, it does involve refinancing.

And I think that eliminating the right of recision would be a step backward in the fight against predatory lending.

MEMBER ROBERTS: Sheila?

MEMBER CANAVAN: If the problem is a secondary market problem as opposed to an origination problem, then the question becomes who has greater power to solve this problem.

And if the problem is sloppiness in the marketplace, or fraud in the marketplace, or predatory practices in the marketplace who has the greater power to solve those problems?

And I think it's the secondary market participants. For example, the rating agencies can be directed by the financial institutions to do fraud and predatory lending due diligence at the outset, not just credit risk due diligence, and not just technical compliance due diligence.

And they can be asked to look at a greater percentage of a loan portfolio. And Congress can be asked to rate the rating agencies so that we know the rating agencies are doing a good job.

I mean what is the average consumer going to do realistically to address, what power do they have to address these problems? They have very little power.

And I think that, you know, the investors in the market, which is so important in this country, it is the engine that runs the economy, have to be more responsible and exercise more of their weight in the marketplace to correct these problems.

MEMBER ROBERTS: Okay.

Tommy?

MEMBER FITZGIBBON: I just wanted to, there was one other -- or actually two other areas -- first of all it's the right of recision comes really in transactions which not only include refinancings but also secondary financings, the home equity lines of credit and things of that nature.

And here in terms of do you get rid of the right of recision and avoid the opportunity, frankly, to notify other parties who have an interest in the product, of the pledge of this asset for a transaction. And I say that in terms of life is what happens to you between your plans. And that has to do with marital rights and the disclosure to other parties who have an interest in the property subsequent to the original transaction.

And this is, frankly, where in our institution, we're not a big mortgage lender, we're not a big secondary lender or home equity lender, so this is where we catch fraud frankly.

MEMBER ROBERTS: Yes.

MEMBER FITZGIBBON: Because the disclosure went out to Mrs. Jones and Mrs. Jones didn't know that this was actually happening. Or there was a different Mrs. Jones who came to the application. We actually found transactions like that.

I think there's consumer protection beyond just the disclosure about what the transaction itself represents. There is also consumer protection relative to notice given to parties interest in the property.

MEMBER ROBERTS: All right.

Larry?

MEMBER HAWKINS: I think what's a little unfortunate is that the right of recision is seldom used for the purpose of which it was intended to be used. To allow for a period for the consumer to review. I think that very seldom happens whether it's a three-day right of recision or in the State of Texas if you're doing a home equity loan you've got twelve days and then the three -- you've got fifteen days.

And what we normally get is that the consumer calls every day and says is my time up? Well, you know, they're supposed to be reviewing. We say look you've got an opportunity to back out, to decide that you don't want to do this.

But why would I want to do that? I told you I wanted the money and I needed the loan.

Yes, but, you know, the law says you've got time to really review and to think about this thing.

But I think it's very seldom used for that purpose. That what happens is it is used as a kind of tool to trigger doing things way after the fact. That there's not this review in the three days or in the fifteen days.

And then what happens after the fact, they'll come in and see technically if the documents weren't given to all parties who have a right in the property. And if there's some other technical way now that you can kind of dismantle the entire transaction, I wish there were another way to do that.

And often times is well what we've got is the right of recision. Let's see if that was done properly. But it's not used for the purpose it was originally intended to be used for in very few instances by the consumers.

MEMBER ROBERTS: Okay. Other comments on this?

Yes, Agnes?

CHAIR SCANLAN: I actually have a more broader comment about the regulation in general and that is a lot of the commenters were from the smaller banks and they talked about the burden of these types of regulations and the frequency of them.

Believe it or not, larger financial institutions also experience a burden when there is several regulations coming on top of each other.

And if you just take a look at the Fair Credit Reporting Act and FACT Act, many large financial institutions in the fall of 2002 began preparing for what they thought might be occurring in December of 2003, which was a new regulation to extend the Fair Credit Reporting Act.

And you add a merger or an acquisition to that and you find that there are a lot of systems changes, a lot of changes internally, a lot of things that have to occur within the financial institution to comply with the new regulation which, while we don't want to stress the thought of high cost and the cost of compliance, but realistically there are costs to systems changes which, in turn, at times go into fees for consumers.

So my thought is that when there are these new regulations, if they have to be, please allow financial institutions more time to comply with them.

Just yesterday, we sort of had a -- at least I had a little light that went off in my head thinking about the FACT Act and if we're including credit reporting language in our privacy notices. And when is the new law going to come in compliance? Is that around the same time that we're going to be distributing new privacy notices in 2005? Is that going to meet the deadline?

Allow for institutions to have more time to comply with these new regulations and also if the regulators can have more consistent definitions and requirements therein, that would be most helpful.

MEMBER ROBERTS: Good.

Any other last thoughts on this?

Yes? Sheila?

MEMBER CANAVAN: To address Larry's point, there's another secondary market problem, I think, which makes consumers more reliant on what you refer to as a technical defense and that is that in the secondary market, there are contracts such as pooling and servicing agreements which contain terms which either outright prohibit loan modifications or discourage them.

And, in addition, provisions in the Tax Code, which effect the tax status of rights and so forth, which also may discourage loan modifications. So when problems are discovered from the consumer point of view, they're not easy to resolve.

MEMBER ROBERTS: The other topic we talked about under EGRPRA was the Home Mortgage Disclosure Act. And there are some comments the regulators have heard that the thresholds for Home Mortgage Disclosure Act reporting should be increased. Maybe, Hubert, this would solve your level playing field problem in rural areas simply by raising the urban levels.

MEMBER VAN TOL: You know one of the things that I didn't say was in the original law, because of the MSA provision, you actually have very small banks in urban areas complying with the Home Mortgage Disclosure Act. And I don't see why there's more of a regulatory burden for a $34 million dollar urban bank to comply with HMDA than it would be for a $34 million dollar rural bank. So --

PARTICIPANT: Sir, could you please speak up? I'm sorry.

MEMBER VAN TOL: Can you hear me know?

PARTICIPANT: Yes.

MEMBER VAN TOL: Okay, sorry.

The $33 million threshold, you know, doesn't really affect the urban banks any more than the rural banks and yet we have this incongruity on the law in which because there is a branch in an urban area, banks, which have $34 million in assets could be or are required to comply with HMDA whereas rural banks would not be.

And I think that just goes, you know, to the heart of the issue. That decision was made because urban data was seen as being more valuable than rural data, not because of the compliance burden at that time.

So, you know, I do think that the field should be leveled. And I think the way to do that is, actually, myself, is to lower the -- you know, it's just to remove that metropolitan branch language from the rule rather than to raise the threshold at which people have to comply with HMDA.

MEMBER ROBERTS: I understand that that provision is a statutory provision that was enacted 29 years ago. And we've learned a few things, I hope, in 29 years.

I would also just observe that right now, HUD has out for comment its new goals for affordable housing participation by Fannie Mae and Freddie Mac. And HUD proposes a new sub-goal for purchase money mortgages. And that sub-goal applies only to metropolitan areas and largely because HMDA data is so poor in non-metropolitan areas that it's hard for HUD or anyone else to size the marketplace in rural areas.

Well, the consequence of that is that assuming this proposal goes forward as a rule, Fannie and Freddie will have great motivation to focus on purchase money mortgages in metropolitan areas and much less motivation to focus on non-metropolitan areas.

And that's just going to make it even harder for the originators in rural areas to operate their business and harder still for consumers in rural communities in non-metropolitan areas to get good financing and be part of the financial mainstream of the country.

So there are implications for -- when the banking regulators are looking at EGRPRA on issues like home mortgage disclosure, there are consequences that go way beyond narrowly what they're looking at perhaps.

Tommy?

MEMBER FITZGIBBON: I just wanted to add -- and I don't work for Crane's Chicago Business but there was in the July -- June 21st issue of Crane's Chicago Business focused in the banking industry in the greater Chicago market.

And when we were talking about EGRPRA and regulatory issues and all sorts of things, I sort of expected the article to say that there were -- one of the major problems that the banking industry had in terms of turning a profit was the fact that they had so many regulations to live up to.

Nothing in this article that even states that. I mean it's all about competition. It's all about being proficient and professional in the banking industry. And understanding the work in a regulated environment both from the state and the federal level. And also, you know, our shareholders expect us to generate good earnings to share with them.

So I think in terms of at least in the banking industry in Chicago, it doesn't appear that regulatory burden is a major issue in terms of generating profits. It is competition. And it's cost of capital. And it's demand or lack thereof for credits.

MEMBER ROBERTS: Okay. I see Bruce. And I see Ronald.

MEMBER MORGAN: Just to echo something that Agnes said earlier, regulatory burden, it's the piling on, Tommy, of one after another after another that takes time, that takes resources. Twenty-five to thirty percent of my time as a bank CEO right now is spent on trying to deal with regulatory burden. I have a hard dollar cost to deal with the regulatory burden.

Banking is a business. The more regulations we add, we start treating it as a public utility. It is not a public utility. It is a business. And we learn in a business that there's no such thing as a free lunch. It costs something. The bank is harmed in terms of lost earnings to comply with the regulation.

So what I ask the Board members to consider and this Council to consider as we look at the whole issue of regulatory burden is who is helped, who is hurt, and where is the consumer in all of this? Is it in the consumer's best interest to keep adding more and more burden on and in my case, in the middle west, if we drive more and more community banks out of business because they can't cope with the regulatory burden, what do we end up with?

Megabanks? Megacredit unions? Over one billion dollars -- the number of credit unions continue to increase. The megabank mergers, you just can't even keep up with the names. And I can tell you in my experience, the megabanks aren't loaning in the local communities. They're loaning but not in my local community, okay?

They're not loaning in my state. They're taking funds from my state and taking them somewhere else and loaning them somewhere else. And doing good things for people there. That's fine.

But as we think about the regulatory burden, let's think about the fiscal impact. And let's think about the cumulative impact of piling on more and more and more requirements.

CHAIR SCANLAN: I just want to ask, are there any megabanks in your area?

MEMBER MORGAN: Oh, yes, ma'am.

CHAIR SCANLAN: Oh, okay.

MEMBER MORGAN: They go by those funny three initials that I can't mention.

CHAIR SCANLAN: Oh, okay. I wouldn't know what that would be.

(Laughter.)

MEMBER MORGAN: You have them on your pin.

(Laughter.)

CHAIR SCANLAN: Oh, I don't have that pin on today.

MEMBER MORGAN: Oh, okay.

MEMBER ROBERTS: Paul?

MEMBER SPRINGMAN: One of the issues that we grapple with in business is the term re-engineering and what it really means. And as you look at regulations and what we're really trying to get out of them and who we're trying to protect and what the value of that really is, at some point you have to step back and say what are we really trying to get done.

Yesterday we looked at a report that Glenn Canner reviewed with us about more data being generated and cutting it up all these different ways. What's the benefit of now asking someone to put more information in, more analysis?

I'm just saying at some point we have to step back and say looking at this whole pile of regulations, what are we trying to, you know, achieve for the consumer? What are we trying to get out of business?

So we can do it more efficiently and get to the end result that we're really trying to get to.

MEMBER ROBERTS: Clint?

MEMBER WALKER: First of all, I think Robin did you --

MEMBER COFFEY: Yes, I was going to follow up on --

PARTICIPANT: Do you have a rebuttal?

MEMBER COFFEY: No, not so much a rebuttal but it came up in committee yesterday when I said, you know, in the last month I reviewed two investment prospectuses to invest in small banks or start up the banks.

In Illinois, at least and I'm sure we're not alone, there is a lot of community bank charters being awarded. There's a lot of competition to start up new banks. But in reading through the last prospectus, 44 pages of very small print, there was less than one paragraph that dealt with how compliance would be handled.

And I understand, you know, we are in a regulated environment and compliance comes along with having a regulated bank. Most of these banks when they start off outsource their compliance. It's done via software, it's done via an outside attorney. But compliance is not a burden -- it doesn't become a burden until a bank gets to a certain size and then they start to realize how much the regulations start to impact their business from growing even more.

So when we talk about all these regulations -- and yes, there's a lot, and it's cumulative, and as you try and move into either new business lines or grow and expand your business, that's when you start to feel the effects. And that's when your, you know, your ROEs, all your returns which aren't there in the beginning anyway, don't materialize as quickly as you originally hoped.

MEMBER ROBERTS: I still have Clint, Hubert, and Tommy. And we're limited in time here. And Larry, you'd like to get in, too?

MEMBER HAWKINS: Well, now I would, yes.

(Laughter.)

MEMBER HAWKINS: I just want some clarity on what I just heard.

MEMBER ROBERTS: Okay.

MEMBER HAWKINS: Can I go now?

MEMBER ROBERTS: Sure.

MEMBER HAWKINS: You almost made it sound like if you're a small bank, you're okay. It's not until you start growing that you have problems with regulatory burden? That's not what I heard is it?

MEMBER COFFEY: No, I'm saying that regulatory burden is not a reason a bank does not decide to start. If you put your business plan together and you knew you had regulations as a part of your business, you make the decision to either start a bank or not start a bank.

To say after you've started -- you've acquired your charter that oh, my God, there are so many regulations we're never going to make any money at this, is not the way to run any business and it's not the way to go after a charter.

MEMBER ROBERTS: Okay, Clint?

MEMBER HAWKINS: Great. Thanks.

MEMBER WALKER: I would just like to echo briefly what Agnes, and Bruce, and others have been saying that, you know, there is a cumulative effect to a compliance burden. And then make a specific request.

I understand that the Board is going to be conducting an open-end Reg Z review starting this year. And I would love if they could put in an EGRPRA component of that review.

There are a lot of things in Reg Z that I think are unnecessary like daily figuring of rate, some things that I think are confusing. And also to see if there's ways that the

Board would take their view to make that reg consistent with other regs, such as Reg E. If they could do that component on their review, I'd be appreciative.

MEMBER ROBERTS: Okay. Hubert?

MEMBER VAN TOL: I just feel the need to challenge Bruce here as I am a fellow rural resident. Bruce, within 20 minutes of my home, I can go to a town of less than 1,000 people that has two banks. And all of those small towns throughout the Midwest have -- almost all of them have a bank.

The grocery stores are going. The pharmacies are going. The hardware stores are going. You know all of those businesses would love to have some sort of protection against the long hearts.

But if we live in this capitalist system where, you know, there's a kind of a free market, big dog win approaches, why should the community banks be spared the same regulations that the larger banks have to deal with?

HMDA data provides a very valuable resource for our communities in trying to figure out where lending is being done, who is doing it, whether there is discrimination in lending.

And I can't see why, you know, a smaller bank collecting that shouldn't be required just as well as the larger bank because I mean I think you're doing very well out there.

(Laughter.)

MEMBER MORGAN: A 30-second rebuttal?

MEMBER ROBERTS: A 30-second rebuttal.

MEMBER MORGAN: A 30-second -- Hubert, we have 105 counties in the State of Kansas. We have some counties without a community bank now because of the regulatory burden. If we do not address the costs of the cumulative effects of the regulation, we will no longer have those banks in those communities.

I believe in letting the marketplace decide who is going to survive and who is not going to survive. But that's not what's happening.

We have regulatory agencies putting additional burden, trying to turn community banks from capitalist institutions into regulated utilities. And that's not what they were meant to be. And it's effecting the dual banking system in our state. And the dual banking system is very important to the overall financial services system.

So I would only say to you if you have your way, you will have less community banks and less financial services in rural areas.

MEMBER ROBERTS: Two very brief comments from Tommy and Ruhi. And then I'm going to turn it back to Agnes.

MEMBER FITZGIBBON: I'll pass it.

MEMBER MAKER: I just needed to respond to the point -- comment made about HMDA data. I think the Fed has done a fantastic job of the new HMDA regs. And since Glen's name was mentioned, I wanted to commend the Fed for the new regs.

Remember the law remains the same. Yes, you are gathering spread data. But all of those new tables will be generated not by the lenders but by the Fed. And I think it's fantastic.

And I particularly want to take this opportunity to thank the information that will be available because it will be hugely helpful to community groups who can't cut the lard at the raw level, that, for example we can do.

And I think great work and hopefully you won't let the lenders talk you out of doing more data. Thanks.

(Laughter.)

MEMBER ROBERTS: Well, we could go on.

CHAIR SCANLAN: How could we end on that note?

MEMBER ROBERTS: But we won't.

(Laughter.)

CHAIR SCANLAN: But we will.

MEMBER ROBERTS: So I want to turn it back to you, Agnes.

CHAIR SCANLAN: Thank you very much, Buzz.

Let's move on to Janie Barrera and the discussion of foreign bank remittances and access to financial services of new immigrants.

MEMBER BARRERA: Thanks, Agnes.

Immigrants in the United States send money to their home countries. In 2003, remittances were estimated at 90 billion dollars. So the immigrant market can represent significant profit potential for retail financial institutions.

So yesterday during our discussions, we talked about the infrastructure that's in place, the fees, the market competition, and the customer service.

And James Garner is going to open our discussion right now to describe the services that his bank provides. And then Ruhi will follow and talk about or make some comments from the customer and the consumer side.

MEMBER GARNER: Thank you, Janie. Can you hear me?

PARTICIPANT: No.

MEMBER GARNER: No? Okay. Is that better?

We had a good presentation yesterday from the -- you still can't hear me?

PARTICIPANT: Right.

MEMBER GARNER: There you go. How's that?

We had a very good presentation from the staff yesterday to kind of open this topic up. And one of the things they talked about was the challenges for the unbanked communities and the cost of wiring money back to -- from this country back to the home country and the traditional wire services.

And kind of to kick off that discussion, I guess there was some good news and bad news. The good news is the prices have come down, I think by almost 50 percent. But the bad news is they're still higher than they probably should be.

And to kind of kick off the discussion, I mentioned some of the things that CitiBank has done in the past year that we think has helped bring down some of that and has contributed to the competition that's helped that process.

And basically Citi has three products that I'll mention briefly for this morning's discussion. One of them is back beginning in April of last year, we created what we call CitiBank global transfers and that allows a customer in the U.S. to be able to wire money to anywhere in the world, but particularly for customers sending money to Mexico, they can, for a flat fee of five dollars, they can wire money back to Mexico to the customer in Mexico.

If he has an account at our BanaMex affiliate there, he can pick that up -- use his ATM or any other means of accessing that account. If he doesn't have an account with BanaMex, he can go directly to a Banamex branch and for an additional three dollars, pick up the money there.

So that's one mechanism we have. You can also use it to send money anywhere that CitiBank has in the world.

The other account that we have is relatively new. And that's what we call an access account. And that's a checkless checking account, if you will.

Our market research indicated that a lot of the reluctance of some of the population to open a checking account was they were uncomfortable with writing checks, fearing that they would get overdrawn. And that one of the means of providing an alternative to that was a checkless account where you have a debit card you can use at an ATM or you could use in a store like you would a debit card anywhere.

And if they don't have the funds, then they can't use the account.

So you can have that account opened in the U.S. and you can also have, if you have family back home in Mexico, you can have a -- what we call a Tricolor card in Mexico for the Mexican resident who can use that as a debit card as well there.

So you deposit the money in the U.S. in your access account. You have a debit card here. Your family back in Mexico has a Tricolor Card that they can use at any Banamex or ATM or as a debit card in Mexico.

So those are the two accounts that we have or two methods we have, services we provide to send money back directly. We also have something we opened last month which is a credit account. And that's the credit card, binational card that we've opened.

And I don't -- that allows you to have a credit card account that's based on the U.S. customer's credit worthiness. And you get two cards. You get one in the U.S. for the U.S. customer that they can use like they would any MasterCard or Visa. And you also get for the customer in Mexico, they get a Banamex card that they use there.

The U.S. customer whose account it is, they get the bill. They have to make the payments but the Mexican customer also gets a copy of the bill as to the charges that are generated in Mexico.

The U.S. customer has the ultimate responsibility for the account but it also allows the Mexican customer to make payments on the account if they want to at Banamex.

The U.S. customer can set the credit limits differently for the family who are residents in Mexico than the credit limit in the U.S. So it's a means of having a credit card, Visa-, MasterCard-type of a situation for your family back in Mexico to give you credit as well as sending -- wiring money back.

Some of the challenges we talked about yesterday and will probably lead to further discussion was the how do you get -- overcome some of the cultural objectives that immigrant populations have of using bank services generally as opposed to the traditional wire services.

And we also had a discussion about that goes beyond just the immigrant population in the U.S. There's a certain reluctance to use banks on some of the U.S. population as well.

And with that, I'll turn it back over to Janie.

MEMBER BARRERA: Ruhi?

MEMBER MAKER: I think I wanted to frame the discussion and I'm going to, for simplicity's sake, talk in terms of three kinds of immigrants. And I'm horribly simplifying here but for reasons of time.

You've got the documented -- let's say the farm worker. You've got the undocumented farm worker. And then I'm talking about the more financially sophisticated immigrants from, you know, South Asia, you know, parts of Asia, even eastern Europe, et cetera.

So I want to first address the documented and the undocumented farm workers, many of whom are from obviously Latin America. Speaking of the undocumented, obviously you've got the problem of the fact that they're undocumented and they're going to have a reluctance to use a financial institution. And I think the use of the metriculars cards and expanding that concept toward the other countries is obviously something that we need to be working on.

Too, because I don't have farm workers as clients, I reached out to a legal services office in Texas called Texas Rural Services that works with farm workers, documented farm workers, not just in Texas but throughout the south. And spoke with one of the advocates there.

And essentially he described to me why they don't use banks. And fairly obvious, maybe, you know, you work from sun up to sun down. And the banking hours don't work.

So what they, in fact, do and I'm not a proponent of Wal-Mart but they go to Wal-Mart, they get their money order there, they get their, you know get a phone card there as they do other purchases. And they actually can.

And what was suggested was using, you know, a bank like Citibank or Chase, et cetera, and tying it up with a Wal-Mart or some other retail outlet that is open 24 hours a day.

And the example he gave was that they would go, they would give their money to someone at Wal-Mart and then they would buy their phone card and then they would call up the person whoever it was in Mexico or wherever and say I've just deposited the money and you can now go pull it. And so this instant transfer of cash that could occur without the higher fees that are paid through remittances, et cetera.

Moving on to the financially sophisticated consumers who are high wealth consumers, you know I can speak particularly for South Asia. That's where I'm originally from. The reality is there are often two economies in some of those countries because of the high taxation, either property or income tax.

And many high wealth people don't want any accounting of the fact that they actually have that wealth. And, of course, banks create a record. How you are going to come around that problem I think is very, very difficult.

You know there are two sets of books. You know very wealthy individuals, you know whether you have homes, you have businesses, you have the real worth and then you have the declared worth.

And if you use the money, for example, to have an investment back in your home country, you're not going to want a record of that because that investment will, in fact, be recorded at a fraction of the true cost of that investment.

And when you put it through the bank, you know, you've got a record that can be, you know, and as governments change systematically, bank accounts are seized. I mean it happens all the time. I can practically -- I can actually speak from personal experience from my family, you know.

And records are seized, bank accounts are frozen, property is seized. And even in "democracies", certainly for Pakistan, this is the case. And so I think that's a real challenge.

And I think because of some of the concerns around, you know, Homeland Security, how we're going to come around that is not going to be easy. And I don't really have a solution. And I think it's something that's going to have to be thought through.

By trying to move as much of the remittances into the legal arena I think is definitely something that we should be aiming for and essentially trying to get the farm workers, et cetera, into the banks.

And I would propose if there was some way to actually give CRA credit for this kind of work, I think that's something that we should encourage. And even though it may mean CitiGroup will get CRA credit, I will recommend that.

(Laughter.)

MEMBER GARNER: Thanks, Ruhi.

MS. BRAUNSTEIN: Actually, can I comment on that for a second, Janie?

We have, in fact, recently the Chairman wrote a letter along with the heads of the other agencies to the Hill. We were asked the question about CRA credit for remittances.

And so we have an interagency letter that has been made public where we have said that we would give positive consideration for remittances when they are serving the needs of low- and moderate-income people.

So that is something that is on the record.

MEMBER MAKER: I think that is very helpful.

MEMBER BARRERA: Larry?

MEMBER HAWKINS: So we're not talking about CRA credit for tax evasion either on the high end or the low end, right?

(Laughter.)

MEMBER HAWKINS: Because apparently it seems like a lot of this involved moving money that folks don't want the governments to know. They may, and I do believe that it's going to be a continuing challenge.

I don't think it matters how late the banks stay open. A lot of the potential customers on the high end and the low end don't want especially their identities to be known as they send some of this money. They're looking for convenience and Wal-Mart provides that.

But I think it also allows them to be pretty anonymous. They don't have to provide a lot of identification and so on and so forth that the banks by, you know, just some of the regulatory requirements that we have, require additional identification before we can do some of these transactions.

So I think there's going to be a real challenge to see what we do with some of the laws that the banks have got to comply or how you ease some of those laws to allow these folks to remain kind of anonymous, which seems to be a part of what needs to happen as they send their moneys.

Because we're not only talking about your migrant farm workers, but like in the City of Houston, if you essentially, you know, decided that you were --

What we had happen one Tuesday, the rumor got out that there was going to kind of be an inspection on construction sites and what have you. And all the construction in Houston almost stopped because there are a lot of workers probably who are undocumented who work on a lot of construction sites.

I think they do a wonderful job in the economy in terms of keeping the costs down. But I think a lot of those folks are the same ones who are getting moneys back home to their families.

MEMBER BARRERA: Diane?

MEMBER THOMPSON: Yes, I am just glad to hear about the letter encouraging the CRA credit for products that serve the needs of low and moderate income consumers. As we've heard, there's certainly a clear need for this.

And as the recent study from Pew demonstrates, the costs have been very slow to come down in this field. And increasing competition from financial institutions is definitely to be encouraged.

My concerns are to make sure, and I'm sure they are concerns shared by the Board and the staff, to make sure that CRA credit is given appropriately for products that genuinely serve the needs of low- and moderate-income consumers.

It's the same concern that we've talked about before and will probably talk about again a little bit later today in terms of giving CRA credit for home lending, that you want to make sure that you're not giving CRA credit for products that are abusive in any way.

And the two specific areas that I would specifically ask the Board and the staff to consider as they issue Q&A on what's required in order to get CRA credit, are to make sure that the costs are low.

It sounds like the CitiFinancial program is, in fact, a very low-cost program and from what Benjamin has told me about the Save/Send Program at Bank of America, that also sounds like a very low-cost program.

However, I note that Dr. Ozorco found that despite bank participation, that fees had not dropped dramatically in the remittance area. So that indicates that there are perhaps some banks that are not actually pricing their products in a manner that's affordable and competitive compared to other remittance programs.

The other concern I have is to make sure that there are some -- that these are either covered by Regulation E or that there is some other provision for similar loss limits in dispute resolution. The last thing that I think we want to encourage are programs where we have low-income workers sending -- having on a card all of their accumulated wealth that they're trying to transmit home that falls into the wrong hands, gets lost in the data transmission stream, you know, gets mis-credited or mis-debited.

That will represent significant sums to families. They are going to need to have some way to resolve disputes quickly, fairly, on both sides of the border.

And those are my two concerns with the CRA credit. And I'm sure that the Board will address those as it moves forward.

MEMBER BARRERA: Hubert?

MEMBER VAN TOL: Yesterday we heard a presentation from the Board staff about your work on the ACH Program and aligning those with those in other countries with the Mexican Central Bank, et cetera. I hope as you continue to do that, you keep the possibility in mind that CDFIs in this country and small community groups are given the opportunity to develop their own remittance programs.

I think like Ruhi, I'm happy to see CitiGroup get CRA credit for doing this. I think one of the ways that you can ensure that, you know, we help keep them honest is to offer community groups the possibility of developing relationships with our peers in other countries so that we can also, you know, offer programs like this should it be a simple thing to do at the CDFI level or something like that because I -- or even for small banks and credit unions to be able to do that.

MEMBER FITZGIBBON: Thank you, Janie.

There were a couple of things that I think came up in the discussions yesterday that might be important for us to get out on the table.

One is that there's -- we think that there is a certain share of customers that we can address with a conventional systemic remittance system. It isn't going to capture all of them.

And that the conventional wisdom is that the customers will, in a way, self select the best alternative given either their personal circumstances or apprehensions or the place in which they want to send the money to because there are different delivery systems on that back end that are really out of our control in this country.

So I think that we have to think about what can we do to help encourage the development of a more efficient and more accessible remittance system that bank customers or people that work in the conventional banking industry here in this country can access so that it's less expensive, more efficient, more reliable, has this sort of tracking in place so that people don't lose credits or debits. I think that's an extremely important part of this whole process of developing a reliable remittance system for people to send money back home.

I know in our market where we have relationships with -- Chicago's sister city is Kiev in the Ukraine. And a great share of our customer base is Ukrainian or Russian or Polish in addition to Mexican immigrants as well.

And a great share of the remittances that have been going for the last 50 years or 60 years, this just didn't happen last week, have been going through relationships, banking relationships, that were instituted with other foreign banks in our market who help us transfer money.

PKO Bank, Pekow Bank, Bank BP, and others in Poland, and certainly recently with some of the extensions into the Ukraine with conventional banking industry there although that's still sort of rough in the Ukraine right now.

But I think the important thing is for us to focus on building the best, most efficient, most reliable remittance system so that the confidence factor -- it's a confidence factor -- you have immigrants who come here from other countries with different cultural experiences relative to the banking industry.

There aren't banks, there weren't banks in certain markets that people could rely on. So we need to build the best, most confident system that's there.

I just want to give you one example of that confidence factor. A bank across the street from us in our neighborhood on the west side, northwest side of the city, was acquired by a bank in another state. And they said to their customers we don't offer passbooks.

I had to hire a guard to handle the lines of people for 40 million dollars to walk across the street into our shop because that's the most reliable, consistent access to their capital that they're comfortable with.

That's the culture, coming from Mexico, and coming from Poland, and coming from Russia, that we have to be concerned about. And to be able to address in our building of this remittance system.

MEMBER BARRERA: I think part of the discussion yesterday, too, including banking the unbankable and getting, you know, the financial literacy portion into this and also once they get, you know, once they would come into a financial institution, even opening up savings accounts and so on.

And maybe the possibility of not sending the total remittance or total amount that they were planning to send but keeping some of it here in the bank and creating wealth here. That was part of the discussion yesterday as well.

Elsie?

MEMBER MEEKS: Yes. Yesterday when we were talking about this, it seems that corporations have learned to use ACH, I mean really utilized it for employees. And we decided not to focus our discussion so much on that.

But I think it really -- it did bring out a couple of interesting points. One, I know that the capacity in a lot of these other countries, you know, aren't as it is here. The delivery system or the receiving system maybe isn't as good. So that, you know, that is out of our control.

But I think as more corporations do this -- and we said well that's really not the consumer side -- but, in fact, they're doing it for their employees. So those really are the consumers. And as that becomes more of a normal part of doing business or receiving their paychecks, I think that will grow.

And it brought me to mind, you know, so many people on Indian reservations, we live in a cash society or have because of hardly any banks in the area. But after the government encouraged people and, in fact, almost required them to set up banking accounts so that they could do the electronic transfer funds, I think that really make a difference.

And so I think that this, you know, will grow over time. I mean obviously this is part of our whole new economy and our whole technology. But --

MEMBER BARRERA: Mary Jane?

MEMBER SEEBACH: Yesterday, Robin made an interesting point about Union Bank apparently set something up where they were next to Western Union.

MEMBER COFFEY: We did, too.

MEMBER SEEBACH: Did you? Can you just talk a bit about that? It was sort of an interesting point.

MEMBER COFFEY: It revolved around -- getting back to talking about the unbanked, we set up what was a pilot program to -- it wasn't so much a currency exchange but in some of our bank branches and then on the street in a storefront next to a Western Union office, we offered wire transfers -- to send wires back and forth primarily in Hispanic areas. That's where these three branches were set up.

And what we found, and it was interesting because it's very parallel to what Union Bank of California, I believe, found when they have also offered this similar service.

And that is there were high hopes of converting those people who came in on a regular basis every week, converting them to becoming bank customers. And converting them to the financial system here.

And after -- I think Union Bank looked at it after a one- or two-year period, we looked at it after a one-year period, and only about 15 percent of those weekly transactions got converted to our -- becoming bank customers.

So it's very -- I think you find that you kind of hit the -- if you want to call it the cream of the crop, but the conversion rate is extremely low which, I think, is one of the reasons why there aren't more banks in this particular system or trying to get at this particular customer base.

It's extremely time consuming. There's a lot of -- it takes a lot of time to complete a transaction when you're not able to convert them to your customer, it's -- the other thing we found is that people -- the cost of the service was not what drove the people to the service.

If we were right next door to Western Union, we couldn't convert customers -- we couldn't convert some of those to customers, again because of the procedures you would have to go through to open up an account with identification. And then just the fact that there would be records.

But if we offered the service two, three, and in some cases we offered the service free on certain holidays, people would still go to Western Union just because of the perceived -- the perception that it was more anonymous, which is what we talked about earlier.

MEMBER BARRERA: Paul?

MEMBER SPRINGMAN: You know if we look at the remittance transaction as if we're at 1,000 feet and go up to 5,000 feet and look at the population of immigrants and where we're trying to go.

We've done some work with a number of our clients on the Hispanic market. And you've seen a lot written about it in the last six months or a year where it's a population of 39 million. It's growing every month.

And they talk about the needs of this population. And they break it into really three categories. It's the unbanked, which we've talked about, and there's really two pieces to the unbanked.

It's the new immigrants coming to America and just trying to get knowledgeable on what they can do. It's the unbanked who just will never trust banks and who will just never get into it. And then there's the transition group who may begin with a checking account and try to work themselves into the mainstream economic system.

And then there's the banked. And the banked group is the population that's growing significantly. They're starting to buy homes. They're trying to buy new cars. They're trying to build up their credit history.

And I think Janie talked about how do you educate them? And how do you get them more knowledgeable of how they should work through that long-term life cycle of working their way into the credit system?

And it's a terrific challenge for banks. And it's a terrific opportunity for banks to really look at that market and how do you educate that population and really work them in to let them take advantage of the opportunities that exist here in America?

MEMBER BARRERA: Agnes, those were the main topics and areas that we wanted to address today.

CHAIR SCANLAN: Okay. We have a break scheduled for eleven o'clock. Perhaps we could take it now and everybody come back by eleven. Then we'll start up with their conversation on courtesy overdraft protection at that time.

Thank you.

(Whereupon, the foregoing matter went off the record at 10:43 a.m. and went back on the record at 11:01 a.m.)

CHAIR SCANLAN: We're now going to turn to the topic of courtesy overdraft protection. And Ken Bordelon will start that conversation for us.

MEMBER BORDELON: Thank you, Agnes. Is the microphone okay?

PARTICIPANT: Yes.

MEMBER BORDELON: We'll refer to this as bounce protection just as a brief summary for the Council members and the Governors attending.

The Council actually discussed this at the public meeting last year. I believe it was March this subject was brought up.

During that discussion, much of the controversy, if there was some, centered around probably the marketing aspects of the program. And since then the staff has received comments regarding the programs and we're back to the issue again.

During the discussion last year, two central points were being raised. Basically the consumer groups argued that the bounce protection program should be covered under the Truth In Lending Act since it's basically a loan product.

Industry groups preferred and argued that the program was basically exempt from TILA back as an ad hoc exemption under the rules back in 1969 and should be kept under the regulation of Truth in Savings.

The Board has basically agreed in the pronouncements that have come out and stated that bounce protection programs would be covered under Reg D. But they did stipulate that if problems persist in the program, that they would reevaluate and take a look at it in the future and reconsider bringing the program under TILA.

In our committee discussions, several variations of the bounce protection programs were brought out to the Council members. First, I guess, the traditional bounce protection, or overdraft programs, actually, I think in our agreement, we came up with about four different programs that are in the market out there.

The first one is the traditional program where the consumer or member has a mutual agreement with the financial institution. It's a written agreement. And there are overdraft privileges that are afforded to the customer either in an overdraft through a savings account or through a loan account. And then if it is a loan account, there is a written loan agreement and TILA takes care of that coverage.

The second program that institutions cover is basically an ad hoc discretionary program. It may or may not be automated but most of them, I guess, could be considered as part of a relationship pricing formula where certain criteria are applied, and those overdrafts are paid.

The third program is basically an automated system in house where the criteria are all totally set up by the institution.

And the fourth is where the institution contracts with a third-party vendor and that vendor helps the institution to identify, market, and administer the program.

And I think both committees agreed that the fourth program is the one that caused a lot of concern.

Since then, two pronouncements have been made regarding the bounce protection program. The first is that interagency guidelines were issued and are up for comment. The guidelines covered safety and soundness, the legal risks, and best practices. And those best practices brought out some discussions in the committee also.

The Board also has proposed an amendment to Reg D. The Reg D proposal addresses two basic issues. One is disclosures of the overdraft programs and disclosures are basically covered on the up front, in account opening, and on periodic statements.

And the second deals with advertising and misleading advertisements.

The periodic statement disclosure change, as proposed by the Board, includes aggregating NSF fees on the periodic statement, which is normally a monthly statement, and reporting that to the consumer on, say, a monthly basis and a year-to-date basis.

The proposal includes aggregating those fees for those institutions that provide bounce protection programs formally and for those that do not. And the Board did invite comment to see what kind of response from both industry and consumer groups would be regarding whether those two should be distinct.

So needless to say, again, just like last year, it was a hot topic. And both committees, the DDS committee and the consumer credit committee had this topic and I thought it would probably be good to start a discussion – since there was considerable comment from the consumer groups regarding that, the Board should perhaps reconsider covering these programs under TILA – we should start the discussion from the consumer group's point of view. And I'll ask Diane to do that.

MEMBER THOMPSON: Thanks, Ken.

I wanted to start by -- a little by talking about where -- one of -- the reasons why consumer groups and consumer advocates are so concerned about these products and to talk a little bit more about how they work and where our concerns play out.

So the issues are that you have a checking account. And you may or may not be aware of the fact that there's overdraft protection on this account. You may have received marketing materials that say things like money doesn't grow on trees but this comes as close as possible. Or no money, don't worry, we'll cover you. Or you may not have.

You may write a check not being sure of how much is in your account. Or you may go to an ATM thinking that you have money in your account because what it tells you on your balance is that you've got -- it includes the overdraft limit and you draw out money.

Many of the people that complaints are heard from by consumer groups typically are recipients of government benefits, low-income recipients of government benefits who are receiving their government benefits into -- direct deposit into a checking account.

They access those government benefits at an ATM or with a PIN-based point of sale and unbeknownst to them, included in the funds that are labeled as available is money that's a loan, essentially, that the bank expects to be paid back and the bank is charging them a fee for advancing them this money.

There are two serious -- well, there are several serious issues with that. One is whether or not consumers understand that this is going to happen at an ATM or at a point-of-sale transaction, which is not how most of us think about overdrafts being covered.

The other issue is how it's marketed. Are consumers being encouraged to overdraw their accounts? Are the most vulnerable consumers being encouraged to overdraw their accounts?

And then out of that comes sort of a third question. To the extent the consumers are aware of this and using this as a stopgap measure because they don't have the funds in their checking account but they think they will soon, are consumers being given the information they need to make a rational decision about whether or not they want to overdraw the account or look into a line of credit, take out a payday loan, or simply not overdraw the account?

Do they understand what the real cost of that is to them? This is, I think, from a policy reason why the TILA coverage is so important because TILA provides for the APR, which includes not just the interest rate on a loan but also all the fees and all the finance charges, all the costs of obtaining that advance of credit.

And it gives people a uniform shopping tool. Now this wouldn't be -- in this case, there would be no way to tell people what their APR was in advance but people would get it after the fact.

It could serve both as shock value but it would also serve to let people see afterwards you know I paid 1,000 percent APR for that 40 dollars that I got out. And I could have done better by going to a payday lender.

And that's really the concern, is that unless you cover it under TILA and provide APR disclosures, you don't provide a way for people to comparison shop and to understand what the true cost of taking that bounce loan out is.

The Board has acknowledged repeatedly that bounce loans are credit. It fits squarely within the definition of credit in TILA. The question is whether or not there's an exclusion that applies to take it out of TILA coverage. And I have a difficult time finding an exclusion that fits to permit to take it out.

The traditional exclusion was that it was a purely discretionary ad hoc provision. These programs, as Ken described, have evolved beyond that even though the bank often nominally retains discretion, as actually any lending institution does whenever it accepts an application from anyone to make a loan.

In fact, the process is largely automated. Many of the decisions about whether or not credit is going to be made have been made in advance. And many lenders are encouraging borrowers to take advantage of this, for the very reason that this has become a very profitable line of business for many financial institutions.

But to look at the exceptions under TILA, you have to look at Section 105, which provides for exceptions. And the -- even if Section F doesn't apply, which sets out a very onerous standard for what you have to do to except something out from under TILA, Section A requires that the exceptions, in order to have an exception from TILA coverage, it has to be necessary to effectuate the purpose of the title, the purpose of TILA.

And the purpose of TILA is to ensure meaningful disclosure of credit terms. I would submit that there is no more meaningful disclosure of credit terms and no way to get a meaningful disclosure of credit terms without the APR in this case. And I don't see how that can be properly excepted.

There have been some concerns about whether or not it would be possible, whether or not TILA disclosures would kill the program. Whether or not -- in general, TILA disclosures have not killed lending of most kinds so I think it's unlikely that they would kill it in this context.

Additionally, you can look at the program that Wells Fargo offers, which is very like a bounce loan coverage and they do do it with full TILA coverage and they seem to be making money on it.

I think that at this moment, that that's probably the sum of what I have to say.

But I urge the Board again to go back and look at TILA to try to understand and to justify taking it out of TILA. If it is credit, as the Board has repeatedly acknowledged it is, there is no good reason not to take it out of TILA.

And TILA is the mechanism for providing a uniform shopping method. If we want consumers to understand what it costs, we have to give them the TILA disclosures so they know what the APR is.

Thank you.

MEMBER BORDELON: Thank you, Diane.

I've got Bruce and then Forrest.

MEMBER MORGAN: While I appreciate Diane's passion for bringing the bounce protection programs under Truth in Lending Act, I think there is a little confusion about what an overdraft really is. An overdraft is not a loan. There is no application. There's no underwriting. There's no note. There's no APR; for a reason.

An overdraft is a deposit service. An overdraft occurs when a customer writes a check or through some other transaction has insufficient funds in their account to cover that item. And that account goes into a negative or overdraft status.

Now Ken tried to distinguish. We have credit products for consumers in banks to help this. It's called various names.

But it's an overdraft line of credit product where the customer does fill out an application affirmatively. There is some underwriting. There is some credit review. And there is a written agreement in place that does specify the APR under Truth in Lending.

I think the Federal Reserve staff and Board's approach in the proposed rule is the correct one. I think the problem here is with disclosure and with advertising.

And I think those proposals under Reg DD, I think are great. The interagency proposal gives the bank examiners some clear guidelines as to what the safety and soundness issues are with these programs.

And yes, a number of banks have gone to vendor-based bounce protection programs and have really been stretching what an overdraft really is.

The consumer advocates passionately say this is the same thing as a payday loan. I would submit to the Board and Board staff that when a consumer goes and obtains a payday loan, they fill out an application. There is some written agreement in place with that payday lender. There is a term. There is a payment.

None of these are present in an overdraft situation. Now you say, well, wait a minute. On the bounce protection program, if they exceed that for more than 30 days, the FFIC tells us, charge that off. And that becomes a negative on the consumer's credit record if that bank happens to report to Check Systems or Telecheck or one of the other vendors.

I would submit that bouncing a check is anti-consumer. Paying a check over is consumer-friendly, whatever mechanism you do it in. And that there is a fee for that deposit service. Those fees are disclosed at initial account opening. And those fees should be and in many banks, to my knowledge, are disclosed on the periodic account statement.

Calling it a loan, as I said, is anti-consumer because when you bounce a check, the merchant -- you have the embarrassment of going back to the merchant, the merchant either charges a fee or refers that bounced check to a collection agency. So you get two charges.

Now I don't particularly agree with the vendor-sponsored programs. I think this proposed rule will help reign in some of the practice that's going out there. But please do not misunderstand what we're dealing with. We're not dealing with a payday loan. We are dealing with a deposit service.

We're dealing with a deposit service that there's no application, no credit underwriting, no term -- I mean how would you calculate APR without understanding the payment, the term, the rate?

And so when consumer advocates mistakenly try to call what is a deposit service a loan, then we get into these very emotional and very heated conversations. It's in the consumer's best interest to have the ability, whether the banks do an automated or manual, discretionary ability to get their overdrafts paid, that's in the consumer's best interest.

And I would consider -- I would ask that the Board and the Board's staff consider what we're really talking about and not get all caught up in the emotion of the issue.

MEMBER BORDELON: Thank you, Bruce. I've got Forrest and then Mark.

MEMBER STANLEY: I have actually quite a different comment from both Bruce and Diane.

First off, I'm not going to comment on whether or not it should be credit or not. Number one, it's not. But that's not the issue in from of us today. It's the Reg DD proposal and the best practices guidelines.

My two comments really address the best practices guidelines. I think that although they are well-intentioned, they will do much more harm than good. I can't think of any context where we've ever had kind of a best practice guidelines trying to address a consumer issue, in this case a consumer marketing issue.

The problem that I have with them are twofold. Number one, in a best practice in the guidelines, it's a laundry list of various lots of different banks are doing. There's probably not a single solitary institution that is following all of them. It's just -- because it depends upon how you run your program.

I am very concerned for two things. Number one, that examiners – while intended to provide guidance to the examiners, what is meant to be guidelines are going to be looked upon as the Ten Commandments. And it's just going to raise more problems than it ever is intended to solve.

And quite honestly, I do think that the persons that will be most served by the guidelines will be the American Trial Lawyers Association.

(Laughter.)

MEMBER STANLEY: You clearly have opened up an unfair and deceptive practice against any bank that is not following all 20 of the suggested practices. Again, they're meant to be guidelines but in this context, again I think they're going to do more harm than good.

Guidelines, best practices, benchmarks. I think those are all good things. I think trade associations have them. We benchmark ourselves against other financial institutions to see where we stand all the time.

But for the regulators to come up with a guideline, an open-ended guideline, I think is -- very well may be injurious.

I do think the Reg DD proposals address most of the concerns. I don't have a problem, I mean we will be commenting on some nuance. I think that we can make the extra disclosures there. But I don't think the guidelines, quite honestly the best practices, should be adopted at all, not just partially.

MEMBER BORDELON: Thank you, Forrest. I've got --

GOVERNOR GRAMLICH: Bruce, could I --

MEMBER BORDELON: Governor?

GOVERNOR GRAMLICH: So you're saying that you would prefer to have no guidance whatever?

MEMBER STANLEY: I think --

GOVERNOR GRAMLICH: What is your alternative?

MEMBER STANLEY: Well, I don't have a problem with the regulators putting out examination guidelines. I mean we see that all the time so we know what we're going to be held to.

These are guidelines that we're going to be held to not just by the examiners but, unfortunately, in courts. And they're very open ended. I'm not opposed to, you know, charge off guidelines. I'm not opposed to safety and soundness guidelines. I'm not opposed at all and actually welcome, you know, call reporting guidelines, whatever.

But in this context, if the Board -- if there are really things that the Board wants to stop, I think that needs to be addressed through a regulation rather than kind of an open-ended attack on them.

MEMBER REYES: So you'd prefer a tougher regulation?

MEMBER STANLEY: I would prefer a clearer regulation rather than an open-ended discourse on perceived best practices. And I do believe the Reg DD proposals actually -- I mean as I said, I'm not opposed to the Reg DD proposals that are on the table. I think those do address what I think is the most egregious elements of the marketing proposals that the Board is trying to address.

MEMBER BORDELON: Okay, Mark, you're next.

VICE CHAIR PINSKY: Thank you, Ken.

I'll try not to turn this into a conversation about passion and dispassion. I'll do my best.

I often feel, you know, when we had the discussion a year ago, Ken, about this issue, I felt like I was falling down Alice's rabbit hole, right? And things kept getting curiouser and curiouser. We had this discussion about is this a loan or isn't this a loan. And I don't remember if that was the issue on the table but I remember that we had an extended discussion about it. And it just didn't sort of make sense to me.

And I just want to be clear that the Fed staff, at least in the documents we got, indicated that this is, you know, what they call a short-term extension of credit. And sort of that's the basis for arguing, you know, whether, as Diane said, whether it should or shouldn't be under TILA.

I think, first of all I think that -- I mean I think this is a deceptively difficult and complicated issue. The more I get into it -- I mean that's why it gets curiouser and curiouser. The more I get into it, the more I understand how true that is. And I think the Fed and the Fed staff have done a really good job of trying to wrestle this one to the ground.

You know, the reality is that most overdraft protection or overdraft loans, whatever you want to call them, really are well intended. I mean we heard about that yesterday.

We had some discussion with some of the bankers and how they offer them and what they do to them, what they don't do. And there was clearly some benefit to them for consumers.

And, you know, there's no question that, you know, consumers like them in some cases and they have some advantages. They may -- given that the question is whether given a choice they would like, you know, an overdraft protection or a line of credit, if they could qualify for a credit, and whether or not a line of credit might not be better for some.

The reality is the way these work out, these are, in fact, loans, as I believe they are, that, in fact, there are instances where payday loans are better deals for the consumer than overdraft protection if you take that view on it.

And I think that the, you know, the effort to focus on what might be called the sort of bad actors, the sort of the overly aggressive, perhaps predatory efforts to induce consumers to use this product to their own detriment in the long term and to the benefit of perhaps the bank or whoever is offering it, you know, through the marketing, through the, the ATM screens that tell you that you have funds available when, in fact, you don't have cash available, you have overdraft available.

You know, we heard a little bit yesterday about some of the tricks that people are taught or learn about, you know, processing high value checks before low -- you know, high amount checks before low amount checks and things like that which I would assume are illegal but I don't know the answer to that and I don't know how that's regulated.

Or, you know, processing the checks before you process the deposits in some ways, right?

And so I think that the Fed staff is trying to get at those issues but I think the issue sort of goes beyond that, at least in my mind. I think the issue really is, you have this product that is beneficial to some folks but -- and I think that it really is at risk.

I think that if you had to report -- if you do report, as I think that banks should have to under the current circumstances because there isn't a better solution, the APR then suddenly -- you know no bank is going to want to offer a product that says that they're offering, you know, 1,000 -- you know even after the fact that the APR is 1,000 percent or 2,000 percent or even 500 percent.

And, you know, I wouldn't consider it unreasonable if banks said well, then we're just not going to offer that anymore. And, in fact, that may then, you know, for banks that may be a loss of an important customer service. For some banks it may be a loss of revenue.

And for consumers it could be a loss of a valuable product for some of them. And for others of them, you know, it may push them to deal with payday lenders. It may push them out of the banking system. I think that those are the ramifications. And that's where the issue gets so complicated.

But, I think that the issue -- but I think that consumers have a right to understand what they're paying for. If these are loans, let's be clear about what they're paying for it even if it's after the fact. The goal -- you know, we talked a little bit yesterday about part of the impact of these fees is to change consumer behavior we hope, right? Manage their accounts better, if they can manage their accounts better, make some more choices, if they can get a line of credit, have them get a line of credit.

But without that information, you're comparing apples to oranges and that's a hard thing for consumers to do, whatever you think about.

I think, you know, the issue of -- I'm not persuaded by the issue that there's customer demand for this product because there's customer demand for payday loans, right? I mean we know that right? There's customer demand for all these products that may be bad for people. That's not, in my mind, persuasive.

And finally, and I apologize for talking so long, a couple other just last observations. One of the things we talked about yesterday in a different committee was ECOA, Equal Credit Opportunity Act, which I knew almost nothing about before yesterday. And now I know just a little bit less than nothing.

(Laughter.)

VICE CHAIR PINSKY: But I wanted to show I was listening because it seems to me there may be issues here that -- we talked about the two different kinds of discrimination, disparate impact and disparate treatment. And it looks to me like there might be disparate impact issues here.

If you look at some of the numbers, at least preliminary that the Fed staff gave us, that a very small percentage of these people, very small percentage of people are using a high percentage of the overdraft products. I'm not sure I'm saying that right but you know what I'm talking about.

That's just a question that I don't know if the Fed staff has looked at but it seems like an issue.

But finally as a complicated issue that's out there in the arena, I think that a really important issue is whether it's going to be the Fed and the banking industry that define how we solve this problem or whether it's going to get defined by editorial writers and advocacy groups and others,

You know there started to be sort of a rush of editorials and commentaries about this because it's now in play, right? There was a New York Times editorial that was not flattering. And I think this issue is going to heat up.

And the question is wouldn't we rather get in front of this issue and try and find a good solution? To me, it starts with TILA. There may be more we need to do with it.

But I'd hate to see this issue get out of control. And I think that there's a potential for a broad brush to smear a lot of good banks, a lot of good consumers, and a lot of good folks.

So thank you for letting me talk.

MEMBER BORDELON: All right, Mark. Thanks.

Before I go on, I've got Elsie, Lori, Ben, Ruhi, and then Clint. I would ask -- and, okay, Sheila.

Two issues that Fed staff has asked us to look at are -- in the comment, one on Reg DD on full disclosure of the aggregation of fees for those institutions that do provide overdraft or for those who don't.

And should those, in fact, be separate or not included for the traditional institutions that don't even offer these programs? Should overdraft or NSF fees be aggregated and reported on the periodic statement on a monthly and a year-to-date basis?

Frankly, from our point of view, from small financial institutions, it is a burden. But in the nature of full and fair disclosure, it may have a good shock effect for some people to look at their statement, the few people who do, to see what NSF fees are actually costing them.

And the other is, you know, what is the cost of having to implement these programs and the regulatory burden on that?

Those were two issues that we were asked to comment on so if you could, Elsie, I've got you next.

MEMBER MEEKS: Okay, well, I probably won't comment exactly on those issues.

MEMBER BORDELON: Right, I understand.

MEMBER MEEKS: That, Mark, sort of complicated things for me. But I try to keep things simple.

Back in my younger days, just a couple years ago or so, I had a problem with some overdrafts and I remember my banker calling me and saying, look, we're making you a loan, an unsecured loan, and we don't appreciate it. And if you don't clean this up, we're going to close your account.

And we get, you know, a lot of, you know, people are always saying well, if we just provide better financial education -- that banker gave me the best financial education I ever had. And as a result, I've made a lot of people in my family clean up their checking accounts.

So I just want to make those two points. One is that the banker made it very clear that this was a loan to me. And so I don't know how bankers, unless there's just a lot of disagreement about what a loan is, can say these are not, they're not extending credit because that's, in fact, what they are.

And the other thing is, you know, to bankers also is -- I mean I do think overdraft, of course there's limits to everything but I think by and large, it just creates bad habits and perpetuates that.

MEMBER BORDELON: Lori?

MEMBER SWANSON: To echo what Elsie said, you know, I look back and certainly growing up it used to be if you bounced a check, you were a bad consumer. We didn't want people to bounce checks. We wanted them to write checks that were good checks.

But now before I came here, I looked up some of the marketing materials that are out there on the Internet and elsewhere to kind of see what is being promoted when it comes to some of these bounce protection plans.

And there is a whole breed of plan out there where the entire business model is to encourage people to bounce their checks, that they can access capital by having one of these balance protection plans.

And that it's a good thing to bounce checks, and that they should bounce checks. And if they're living from payday to payday, one of the ways that they can get by is by intentionally bouncing checks.

And some of that does seem to be targeted at, you know, working poor, lower-income people, people who have government benefits, social security, who are on fixed incomes.

You know I think that as we look at the consequences for that, you know we as a country, we want to make it easier for people to join the middle class. We don't want to rip out the rungs of the ladder behind them as they try to climb up.

And I think that a lot of people when they get into, you know, we want to encourage them into banking relationships as well.

And we don't want them to join banks only to find out they are unwittingly placed into one of these products and have fee after fee imposed where pretty soon by bouncing two 20-dollar checks, you know, they're 300 dollars behind.

And then, you know, the payment is automatically debited out of their account. And then pretty soon their car payment is bounced and they get farther and farther behind.

I think that has large consequences frankly for confidence in the banking system on the part of consumers in that it's not a good thing for our economy.

I also think that we want to -- we spend a lot of time here at the CAC and in our lives, most of us, on financial literacy, on financial education, getting consumers to be good consumers, understanding not only what their responsibilities are but what their rights are as well.

And one tool of doing that is transparency and disclosure. And in that regard, I think that having these types of programs subject to TILA where there does have to be an interest rate disclosure to the consumer is a good thing.

And I think that if products are good, what is there to be embarrassed about? What's wrong? What do we have to hide from the consumer if it's a good product and a product that the consumer ought to have?

Why not tell the consumer what the APR is so that they can be informed consumers? And I think one of the purposes of TILA is to let people shop around. But that another purpose of TILA is to promote the informed use of credit. And so the more information you can give the consumer, in my opinion, the better off the consumer is going to be.

MEMBER BORDELON: Okay. I've got Ben, Ruhi, and then Clint.

Ben?

MEMBER ROBINSON: I won't reiterate a lot of the points that were raised. I think they're all good points to keep in mind. The one thing I would say is that banking is a relationship-driven business. And I think as we look at the relationships that we develop in our industry, it's very important for us to get the whole picture.

So one example is that if we're treating this as a loan under TILA, then perhaps we should try to quantify the benefits to the consumer. And since we can't truly do that, then I don't think that we have a valuable solution by treating it as APR with TILA.

The second thing I'd like to say is that the problem seems to be a marketing problem. And if it's a marketing problem and we're saying that TILA is the solution, then the direct result would be a reduction in bounced checks.

So the question I have is if that, in fact, doesn't happen, are you going to come back and say that TILA and APR are not a solution?

MEMBER BORDELON: Thanks. Ruhi?

MEMBER MAKER: What I want to address is, you know, you've got a good product. You know, Tommy described the product his bank offers. You've got a lot of good products.

And then you have some egregious products. And those are the ones that we're really trying to address. And so how do we get to those?

We're talking about banking the unbanked. We're talking about financial literacy. You know, some of the things that Lori talked about.

And then there's a product that probably results in many of the unbanked who join the banking system becoming unbanked again. And what are the public policy implications of that?

The public policy implications is that you've got the least sophisticated consumers saying I don't want to go to banks, which is why Jim Garner has just his debit card or his credit card, I don't want a checking account because I don't know what kind of fees I'm going to end up with.

You know, it's an incalculable amount because you have this cascade effect where you bounce one and then you have 15 dollars and then you don't pay in time and it keeps happening. And there is a true life story that I'll share with you in a minute about that.

So your public policy implications are, you know, that if we don't control this product, you're going to have the least sophisticated people who we want to bank becoming unbanked.

And, you know, what is the Fed's offer? Their basic offer is well, we know you're doing an egregious thing out there. So what do we want you to do? We want you to do -- essentially make sure you -- when you rip people off, let's not be too open and egregious about it. And that's sort of how I see some of these best practices.

And I see the best practices as everyone is going to ignore them. And, of course, our lenders think that, you know, all us trial lawyers are going to be suing them. So it seems like nobody is happy with this solution.

So I think we need to revisit it. I think this is something that as all those *New York Times* reporters bounce their checks and realize that for 20 dollars, it's going to cost them 100 dollars, that this will become something that the press picks up on.

And I think we need to focus on it, and fix it right. And maybe we don't do it this time around and maybe we go back and look at the problem a little deeper. And come up with some real solutions that will work for all of us because I think some of the solutions aren't working for anyone.

I have a story of someone who is a paralegal's sister who was a volunteer in our office. She was on a fixed income, social security disability. Thirty dollars bounce fee, she spun into a depression. And I'm really not making this up. You know and it's like 30 dollars? You could go into depression that would make you dysfunctional for a while?

You know she'd been doing really better. She'd been volunteering. And yes, 30 dollars in fees can spiral people out of control. And I know 100,000-dollar folks who make that kind of income, it's inconceivable. To all of us sitting around here maybe.

But that's the reality of the world we live in. And so I love it when all the lenders tell all us consumer advocates who've been consumer advocates for like 30 years that what you're really proposing is anti-consumer and you're really an anti-consumer advocate.

So I just wanted to throw that in.

(Laughter.)

MEMBER BORDELON: Thank you, Ruhi.

Let me give you a rundown. I've got Clint, Sheila, James, Hubert, Forrest, and then Buzz.

Okay, Clint?

MEMBER WALKER: Great, thanks, Ken.

I would like to kind of support what Forrest has already said and kind to respond to you a little bit, Governor Gramlich, in that I am very -- I don't offer this product. My bank does not offer this product.

But I'm very concerned about the precedent that would be set by the Fed participating in the FFIC guidelines and best practices. I understand that the Board has not done this in the past.

But I'm very concerned because it really does create a de facto legal standard that will be followed, whether it's by the State AGs or whether it's by private attorneys, or whether it's by private attorney general under California 17200 or whatever. You are creating a legal standard that the banks are going to have to hold themselves up to.

And my very strong feeling is that you should, if you're going to do that, you should do it by regulation. If you feel it's important enough, put it in a regulation. If it's not important enough to put in a regulation, I really would urge you not to issue a best practice.

I do think it's fine to do it for the, you know, for the examiners. I think it's very appropriate, you know, to give examination guidelines.

But I really think that doing best practices could create precedent not just in this area but it will encourage it in other areas that I would like to see avoided.

Finally, and again I apologize to you in this, Dan, but I have to say it, I think the Board got it right in Reg DD. I think you got to, you know, talk about the fees.

I think that's very important for, you know, customers to see, you know consumers to see the fees they are being charged. I think the APR -- when you do an effective APR calculation, it's the most confusing thing and frankly just confuses the matter more than it really helps.

I think, you know, people look at the amount of dollars they're forking out and APR, you see 2,000 APR, you just don't know what it means.

MEMBER BORDELON: Okay. Sheila and then James.

MEMBER CANAVAN: Firstly on the issue of whether this is a loan or a service, I think this product is clearly a loan. Consumers are expected to repay it. And banks charge for the use of the funds.

But if my colleagues here today are going to continue to insist that it's just a service, then I would challenge them to put on the record here how these products are treated on their financial statements.

Are they reported as loans? Do the institutions reserve against the losses? Do they write them off as uncollectible?

And if my colleagues are unwilling to say so, then I think the Fed needs to take a look at this so that we stop using terms that may be inappropriate.

I think that it is a loan product, but not only is it a loan product based upon the information that we were given by the Fed and which is supported by the Department of Financial Institutions from the State of Washington Report, these are a high-cost product.

They are marketed in false and misleading ways by some financial institutions. Consumers can be fraudulently induced by false promises of a free or no-cost checking account. And according to one of my banking colleagues on the Council, this has already become a significant profit center for at least one banking institution and probably others.

So I think the problem for the Fed is if you don't address this now and you take a wait-and-see attitude, then the danger is that this is going to become a more widespread problem. It's going to become a profit center for more institutions. And a bottom line item.

And at that point, it's very, very difficult to deal with it. We are regulating this now only through the Truth in Savings Act if we do it rather than Truth in Lending, which means we're leaving consumers unable to determine the true cost of the loan.

But also they are left without any remedy if they are harmed. There's no right of action and no attorney's fees, which means that state tort remedies are what you're left with.

And they will be ineffective because people will not be able to recover their money because they won't be able to hire a lawyer because the amount that they can recover after the amount of work that it will take the lawyer to do it, just doesn't make economic sense. Litigation or arbitration costs will be too high here.

If what the Fed is afraid of is that proper disclosure is going to kill this product, I'm trying to think of why that would be. If the loan product is killed because the consumer understands the true cost of the loan, so be it.

If the loan is killed because financial institutions are afraid of the reputational risk when there's paper out there which shows the true cost of this loan, so be it.

If it's regulatory burden of further, you know, technical disclosure compliance, then maybe it's time to remember that certain problems are better addressed by substantive regulation rather than technical regulation.

Substantive regulation is more effective in deterring predatory and abusive practices and protecting consumers. But if the industry chooses technical regulation, disclosure regulation, so be it.

I don't recall any of my colleagues actually putting numbers on the table but in terms of how high-cost this product is using the statistics available in the Department of Financial Institution Study, it looks like on the low end, for at least two percent of consumers using the product, the low end is 90 to 160 dollars a month or 1,080 dollars to 1,920 dollars a year.

On the high end, it's 1,600 to 1,200 dollars a month or 7,200 to 14,400 dollars per year. That's one heck of an expensive service.

And I think I share Mark's concerns about the disparate impact. I'm wondering who are these four percent at the credit unions who use the program two to five times per month. And the two percent who use the program more than five times per month. And for banks and thrifts, one percent use the program two to five times per month and two percent use the program over five times per month.

I think the Fed should table this until they take a closer look and find out who is using this product and what impact is it having on them.

And then finally, as a citizen, I would like the Fed to investigate the impact on our military. More and more each day we're reading about the impact of financial products on the military. With costs like that, it's very easy to imagine foreclosures, evictions, and homelessness.

I don't want to see or feel responsible in some way for seeing Iraqi and Afghani war veterans harmed by this product.

MEMBER GARNER: James and then Hubert.

MEMBER KING: Well, I guess my standpoint is that do no harm kind of philosophy. You know here we are saying to the world that there's a product out there and it's being mailed into homes across the country and say money don't grow on trees but this is the second best thing.

And for some groups, that's good news, especially the group who are just on the margin. And it's giving permission to write a check they know they can't cash. And they have 30 days to cure that. And if you don't cure it in 30 days, then they report it to the credit bureau.

And so what are we saying to them? We're going against what we said about teaching people how to use banks wisely. We know if that person came to you who had bad credit, you would not make them a loan. So why would you cover their bad check? They can't pay you at the end of the month.

Up front, you have product, I hear you say you have products but can't cover this. You have mortgage loan products and other products you can say before, as I open an account, here are your options about covering overdraft if they happen.

My aunt is 82 and two years ago, she asked me take over her affairs. She has never, ever written a bad check. And the reason was when she got her checking account, the fear of God was given to her by the branch manager because the fact was African-Americans didn't open checking accounts as she thought at the time.

So the fear if you write a bad check, you go to hell.

(Laughter.)

MEMBER KING: And so they don't write bad checks. She don't write bad checks. So but now we're telling folks it's okay to write bad checks. How does that go back to telling folks to be responsible? I think it's a bad precedent.

If people can't afford to pay their lenders an option, they understand that. They know it's not a bank. They know they're going to get ripped off eventually. But we don't expect that from banks. We do not expect banks to send me a notice telling me it's okay to write a bad check.

It goes against all the principles of banking. Now if you have a good client and you want -- you're able to cover that, I think it's a great thing. But use the product. Tell them up front what the conditions are.

It is a loan. It's a loan. You have to pay it back. If it wasn't a loan, you would not come to me and say give me my money back.

MEMBER BORDELON: Thank you, James.

I've got Hubert and then Forrest, Buzz and Larry.

MEMBER VAN TOL: I think James probably said it much more eloquently than any of the rest of us could. I sort of developed a principle that any time a financial service is heavily marketed to you, it's probably a bad thing.

(Laughter.)

MEMBER VAN TOL: And my little credit union will cover any overdraft that I have for a dollar for each overdraft. They just take it out of your savings account.

I haven't heard that this causes them to be tremendously financially -- that that's a difficult thing for them to do financially. And it seems to me that probably the real cost of covering insufficient funds is very low, in that dollar-, two dollar-, three dollar-range.

So when you have a program that's actually marketed to people on the principle that this is a way to make fee-based income, that just has to be stopped regulatorily somehow. I'm not sure if Truth in Savings is the right way to do it.

But I think I'm in agreement with my colleagues. I think that if you're not going to do it with the APR, then let's withdraw this regulation and try to find a better way to do it.

MEMBER BORDELON: Forrest?

MEMBER STANLEY: A couple things. I think one of the reasons there's so much emotion around this issue is that there is still so much confusion about it.

So many times, and here again today when we hear the horror stories about it -- and yes, there are horror stories about it, it always starts with a check got bounced and then subsequent checks got bounced. And they ran up a huge total for one small overdraft.

But in most of those stories, the check got bounced. This regulation has nothing to do with bouncing checks. The result is if this goes through or if there's other regulations that discourage the practice, the result is that more checks will get bounced.

And in your example, Ruhi, for example, the customer wouldn't have had a 30-dollar check charge, they would have had another charge at the other side.

I don't disagree for a second, and I don't think anybody in the industry does, is that the marketing practices are -- abusive marketing practices should be stopped. Nobody should encourage somebody to overdraw their account. I don't disagree with that one iota. I think that is absolutely necessary.

I also think the proposed amendments to Reg DD address that. I just don't know where -- my institution has offer overdrafts for over 100 years. I just don't know where all of a sudden overdraft became a four-letter word.

And then earlier today, we talked a little bit about EGRPRA --

CHAIR SCANLAN: Which one?

(Laughter.)

MEMBER STANLEY: L-O-A-N, isn't it?

(Laughter.)

MEMBER STANLEY: Well, you got me.

PARTICIPANT: Keep talking, Forrest.

MEMBER STANLEY: We talked a little bit earlier today on EGRPRA and it seemed that that whole conversation went around whether or not the right of recision should be done away with as a regulatory relief.

I mean I didn't even know I was -- I was talking to Diane -- I didn't even know financial institutions had suggested that as one of the regulatory relief measures. I certainly don't think it's a burden. I don't think it's bad. I don't think it should go away.

But this is the type of thing that I think is, you know, when you ask me about regulatory relief, I guess the one thing I ask is just stop. I mean we've got enough on our plates. I'm not asking to take anything away. Just stop for the next three years and let us catch up.

PARTICIPANT: Moratorium.

MEMBER VAN TOL: Just stop doing new products.

(Laughter.)

MEMBER STANLEY: Every hundred years we do a new product, just like this one.

MEMBER BORDELON: Okay. We've got Buzz, Larry, and Bruce, and yes, Sandy, I'm sorry.

MS. BRAUNSTEIN: Yes, I'm sorry. I just wanted to pose a question and I'm just curious about something. And in particular this is really aimed towards the consumer advocates like Diane and Ruhi who talk about cases and abuses.

And I just am trying to figure out, let's say it was covered by TILA, would that really address the concerns I'm hearing you express because payday lenders give TILA disclosures. And that doesn't stop people from using the product, and having high fees.

So say that this protection was under TILA and banks were making disclosures, does that mean people would stop using it? Would that really address the kinds of things that you're talking about today? I guess I'm trying to figure that out.

MEMBER HAWKINS: You're taking away my thunder, please.

(Laughter.)

MEMBER MAKER: Do you want to go first, Diane or --

MEMBER BORDELON: Diane, if you could answer that?

MEMBER THOMPSON: Of course, it's not a complete solution. Disclosure is never a complete solution. I do think that the TILA disclosures are important because I think that it provides for shopping. And I think that the worst kinds of abuses here happen because people don't understand the cost.

And while yes, Clint's right, that it's important to see what the total fees are, you can do that and tell them what the APR is so that people can make a rational and informed choice.

MS. BRAUNSTEIN: I understand that. But I just have -- I mean I just wonder, the users of this product, are they really going to shop? I mean they've got an account and they bounce a -- or they write a check that would bounce except that the bank is covering it. They're not going to shop around before they write that bad check.

MEMBER THOMPSON: I mean I have -- I mean there's one concern which is about the ATM and the point of sale which concerns me greatly, where people don't understand what's happening. And I'm not sure that covering under TILA or the Truth in Savings regulations as proposed take care of that.

On the other hand, I do think that there are people who -- and I see them in my clients every day, who have some rudimentary understanding of this is going -- I don't have the money here. What are my options?

And I've had them come to me and say well, I'm going to go to this place or I'm going to go to this place. And they do make those comparisons. And without the APR, it's not possible for them to make those comparisons.

And it also builds on what we do in financial education is we teach people look at your APR. When you need a loan, figure out what the cost of credit is. And this undercuts that because now we have to say well it's not just the APR, it's what your fees are. And you have to sort of figure out between the two of them what the total cost is going to be.

And that is really an impossible calculation for most people.

GOVERNOR BIES: Just clarify this for me because that's the part where I'm struggling, the APR. The APR to the customer would be calculated with the customer knowing how long in the future they're going to need that extension of credit.

The bank who is paying the overdraft has no idea if it's going to be cured tomorrow or in two months. And so you can't shop comparably because you don't have the same fact pattern calculating that rate.

MEMBER THOMPSON: That's right. You can't do this beforehand with prior disclosures. You have to do this with after-the-fact disclosures. And so that does limit your ability to shop.

But what it does mean is that after you've done it, what it addresses is the repeat customer, the person who gets into the habit of doing this every month four times or more times as the Department of Financial Institutions study in Washington found that there was a significant percentage of people who were doing this four or more times a month.

Those people should be covering their monthly shortfall in income some other way than with overdrafts. There are lots of other mechanisms to cover it whether it's simply reducing their spending, or whether it's looking into a line of credit, or whether it's borrowing money from family and friends, or whether it's taking out a payday loan. Any of those options would be cheaper than running up the fees for four overdrafts every month.

And so if you give people a disclosure afterwards, this is what the cost is. It says, oh, okay, I see that the cost of this -- it's not a free checking account, as they told me when I signed up, and it's not that, you know, it's -- if you take out a payday loan for 100 dollars and you pay a flat fee, if you bounce -- if you do a point of sale at a grocery store for 30 dollars and then you take an ATM for 50 dollars and then you bounce a check for 20 dollars, you're going to have fees for each one of those.

And so you need to have some way for people to comparison and say, okay, I did this at the bank. And this is what this costs. And if I'd done it some other way, this is what it would have cost.

And the only way that I see to do that is with an APR calculation.

MEMBER MAKER: If I could respond, Sandy, I think that is a very good question.

To respond to Forrest, what happened in this particular case is that you have the check protection and you have to pay back in X number of days. And if you don't, another charge incurs and it keeps -- that's how it cascades.

So you don't just have the one-time charge. You have repeating charges because the payment wasn't made. And if you are on a fixed income and you're only paid once a month, you don't even have those, you know, that short amount of money to catch up is how it can cascade.

As to Sandy's point, I think no. I think, too, you know, Diane has already addressed the APR issue. I think you do have to have some of the other mechanisms in place where essentially folks aren't being encouraged to abuse, you know, to end up using this in a way that's financially not helping them.

I think you have to have, you know, proposals where, you know, we've heard about these high to low ways that checks are cashed, where the egregious marketing is done.

And there have to be some ways of limiting some of the more abusive practices which I think do verge on -- you know, we talked about whether or not -- was it a potential UDPA violation, what some -- the Unfair and Deceptive Practices Act violation.

That was the discussion we had in committee. And we sort of tossed it around and we wondered, well, how is it going to get sorted out?

So I think controlling, you know, abusive marketing, and controlling abusive uses of these accounts is, I think, very important. I think they're predatory. And people get stuck, you know.

And I think what happens with the repeated uses is you're in once and then you can never catch up. And we find that with the payday lenders. People can't get out of it once they're in it. And how do you make sure that they don't get in. Or they're aware of what the terms are going to be.

MS. BRAUNSTEIN: But TILA is not going to keep them from getting in it. Like Diane said --

MEMBER MAKER: Right.

MS. BRAUNSTEIN: -- it's going to be after they're already written that bad check they get this disclosure.

MEMBER MAKER: Yes.

MEMBER THOMPSON: But what it addresses is the question of knowing what the cost is and whether or not -- maybe addresses the question of people who are repeat users, which is the most -- was the area of greatest concern to me.

MEMBER STANLEY: Doesn't the Reg DD -- the proposal for Reg DD have that same shock value of seeing them in the aggregate?

MEMBER THOMPSON: It doesn't give you the information you need to make a rational, informed decision, I don't think.

MEMBER BORDELON: Okay. We are going to try to go to about ten after. Is that right Agnes?

CHAIR SCANLAN: Five or ten after.

MEMBER BORDELON: Five to ten after. So far we've got next Buzz, Larry, Bruce, and then Tommy. So we've got about ten minutes left. So Buzz?

MEMBER ROBERTS: I will be brief. As someone who is not expert in this area at all but just trying to pay attention to it.

It seems to me we have two very different kinds of practices here. Some are benign, some are not. And they ought not to be treated with the same regulatory approach.

It seems to me that where there is a courtesy extended on an occasional basis, not marketed, then that ought to be treated one way. And it seems to me that the proposal under DD gets at that in terms of just disclosing how much this is costing.

But for other kinds of practices where there is aggressive marketing, even if it's not misleading marketing, but aggressive marketing, or where you do a point of sale or an ATM transaction where you are led to believe that you have more money available to you than you have deposits, those really should be treated very differently, it seems to me.

And maybe one ought to be called a loan. And the other ought to be considered a service courtesy.

And I don't know that Truth in Lending is an adequate tool for this. You know if you're trying to -- if you have a Phillips head screw to drive and you don't have a Phillips head screwdriver, you'll use a regular flathead screw driver and try and get that screw in there because it's the only tool you got.

But I think if we're in this regulatory construct, where we can never, ever buy a Phillips head screwdriver because we already have a flathead screwdriver and a hammer and nails and a stapler, and that's enough, no more tools, then we wind up stripping these screws and messing the whole system up.

And it just seems to me that, you know, there's nothing wrong with going and getting the right tool for the job.

MEMBER BORDELON: Thank you, Buzz.

VICE CHAIR PINSKY: Are you saying you don't think TILA is the right tool?

MEMBER ROBERTS: I'm not sure it is. I'm no expert. But it may not be. And we ought not to confine ourselves to either "TILA or nothing" because we're in this box and we can never go back to the hardware store.

(Laughter.)

MEMBER BORDELON: Larry?

MEMBER HAWKINS: I'd first of all like to clear up a few items here because people may be concerned.

First of all, don't be concerned. We're not going to lose the war in Iraq because of the overdraft product. And also, you know, I've been in banking over 30 years so I consider myself somewhat of a behavioral scientist so I think I'm justified in being able to say this, Ruhi, your cousin who had the problem because of the 30 dollar overdraft, I hope you know that it's not the 30 dollars. They had some other real issues, okay?

(Laughter.)

MEMBER HAWKINS: So don't leave here believing it's because it's the 30 dollars because that ain't it.

You know historically, overdraft privileges have been extended to kind of the elite. With some of the overdraft products now, we're extending it to more than just maybe an elite handful. I can tell you this for certain, if you decide to disclose under TILA, this product still won't go away.

Nobody's trying to hide anything. We just don't like the additional regulatory burden. I don't have an overdraft platform but if I did have one, and you said, well, let's make him disclose under TILA, we'd figure out a way to pass the cost on. But I can tell you that we'd still have the product and guess what, the people would still use it. Okay?

Now that's bottom line. You got to realize that. If you believe that by adding additional regulatory burden that this is going to go away, it's not going to happen.

And you know what the people understand -- who use these products understand a lot more than probably anybody sitting around this table? They understand broke, okay?

And what happens when you're broke, unfortunately, you use whatever is out there. Now if you take this product away, what they'll do is they'll continue to use, probably in greater numbers, payday lenders, pawn shops, and any other underground means to get the basic monies they need to do what they need to do.

So don't fool yourself and believe, because you try to load on more regulatory burden, that this is going to go away. The way we fix it is with continued education, but to try to keep that segment of the marketplace engaged in the banking industry.

So I'd encourage you not to do things to run these folk off but to try to keep them engaged so that we can try to better educate them. Hopefully the banks will use some of the additional revenues if they have the platform to maybe put some monies into programs to try to better educate.

But what I don't want to have happen is a lot of the customers like we have, you know, I'm not going to say return a check on that poor lady who has got to feed three kids, who works very hard, and payday is in three days, and she's got to make groceries today. What do you do?

MEMBER BORDELON: Thank you, Larry. And I've got the last two to be Bruce and then Tommy. And that should put us pretty much right on schedule.

Bruce?

MEMBER MORGAN: I'll be brief, Ken.

I agree as a community banker very much with what the consumer advocates are saying about abusive practices. We need to identify them. We need to address them. And we need to address them in a way that's positive.

I also agree with Buzz's approach and I agree with what Larry just said. Less than one percent of our accounts have insufficient checks. We do not have one of these products that has been talked about on the abusive side.

But we have to start somewhere. And starting somewhere is for the Board to enact the proposed revisions to Reg DD to increase the disclosure, so we really know what people are really paying.

I've heard numbers thrown out here that I've never seen in 30 years in banking, a customer run up those kind of NSF or overdraft fees. And we have some people that win the overdraft and NSF lottery each year as to who are the most abusive users. But they've never, ever run up fees like I've heard quoted here.

If we have the account opening disclosures and the periodic disclosures, then we will have some tools that the examiners and the auditors and the staff can start getting a handle on how abusive are the fees. And I think in some of the programs I've seen, they're very abusive. And I would recommend we address those.

The other part of the Reg DD proposal addresses the advertising. And I think these are proper approaches. We should move forward with it. It may not be ideal to correct all the problems that everyone has discussed here this morning but it is a start. And it is a start that gives us better information and gives us hard information in which to make a decision.

But I agree with Buzz, we don't need a hammer to fix a problem for a Phillips head screwdriver with saw.

MEMBER BORDELON: Well, Tommy, I think you brought this to the Council about a year ago so it's fitting that you finish it off.

MEMBER FITZGIBBON: Well, thank you.

I wanted to follow up on what Larry said. I think it's very important.

For those institutions like Bruce's, and Larry's, and mine who just sort of have always done this, we've always had good relationships with our customers so when they've overdrawn an account which was on purpose, we might have charged them if they did it more than a few times a year. I mean that would have been one way to enforce discipline on the customer.

But it was rudimentarily unfair because, in effect, it was our best customers. And typically they were not minority or low income who got the most advantages in terms of covering because, frankly, they didn't balance their checking account.

And I sometime would like to take a survey of who in this room actually balances their checking account. I don't think anybody would be surprised.

And so it really is important for us to think about this as fairness issue. Should we not be across the board as an industry? And I think we do, in general, try to cover our customers no matter what to make sure that they're dealt with.

The second is really Check 21 is coming up. Ruhi and Diane for your edification, forget about POS transactions. You go to Wal-Mart today, you give them a check, they give you the check back. They've already processed it, EFT.

So it's not going to be even whether or not it's a POS transaction or a check. That's coming up in September. So pretty soon we're not going to get checks back and checks are going to be processed electronically at the point of sale more so than a credit.

And one of the last things is to take a look at some of the abusers. I think that there's an onus of responsibility that we've taken upon ourselves and our market to develop a checking product for those who have been abused. And we're launching it in July called Fresh Start.

And it's even for customers who have been reported to check systems. We put them on a very disciplined account. We don't cover any overdrafts for a year. And we watch them and try to help them develop the disciplines so that they don't bounce checks. They don't get an ATM card for the first six months, things of that nature -- they don't get a debit card, pardon me, for the first six months. They only have an ATM card.

So there are things that we can do, I think, as an industry to help those who frankly got a totally free checking account that wasn't really totally free. And so it's really important for us, I think, as an industry to respond to that.

And last but not least, Ruhi for your worker, co-worker there, it's important to understand that in relationship banking, Larry can talk about this, Bruce can talk about this, I can talk about this because we're sort of close to our customers, is if she had called me, if she was my customer, that would have been waived.

I routinely, our company routinely waives probably I don't know -- pick a number -- a quarter of a million dollars a year in overdraft charges mainly because we're in the relationship system.

We understand that it's important for us to keep customers with us. Otherwise the megabanks are going to steal them from us and rip them off. So --

(Laughter.)

MEMBER FITZGIBBON: I'm sorry. I didn't mean that about megabanks.

CHAIR SCANLAN: I was going to respond to that.

MEMBER FITZGIBBON: And last but not least is really the Reg DD and the rest of it in terms of disclosures, the procedures of how checks are processed is extremely important, checks and deposits. So the customers can make rational decisions.

If I make a deposit at the A Bank in my market and they have a deposit check hold that has a different characteristic than it is in my bank, it's a five-day hold -- and that's five business days, that's different than in my bank, which is three business days if it's a local check.

And what is a local check? There are all sorts to things, I think, that are much more important for the consumer to be aware of because the APR is interesting but the rest of this feeds into how the consumer ends up, in effect, paying an overdraft charge.

High to low depositing, processing deposits first thing in the morning, or last thing at night will impact it. All of those things I think are important characteristics to make full disclosures to consumers.

MEMBER BORDELON: Thank you, Tommy.

MEMBER DIXON: Ken, can we get in a couple quick ones?

MEMBER BORDELON: Well, I was just going to chide Tommy first of all because this committee had gone through very close with Buzz without mentioning Wal-Mart and you had to do it.

MEMBER FITZGIBBON: Oh, no, no, oh, I did, son of a gun. I'm sorry.

MEMBER BORDELON: Do we have time for about two short ones?

CHAIR SCANLAN: Just a few more.

MEMBER DIXON: Just quickly, it sounds clear to me that there's a perception, frankly both in industry and in the consumer advocates that there's two different products/services being discussed here.

One is the courtesy occasional discretionary -- and I've heard different people talk about different numbers but a couple of times a year would be within the range versus, you know, the egregious, whatever, marketing-driven.

And so I would be curious almost as a straw poll what's the break point? How many times is okay for it to be an accommodation say on an annual basis or a quarterly basis versus when it gets to be a revolving line of credit, which I think is, you know, the other version of this that might be appropriate under Truth in Lending.

I mean Tommy, what's your vote?

MEMBER FITZGIBBON: We look at whether or not more than ten percent of our customers go into overdraft on more than one occasion a month. So it's really looking at a larger base because it's a moving target.

MEMBER DIXON: It's a number, Tommy, not a speech. Once a month?

MEMBER FITZGIBBON: Once a month. Twice a month sometimes.

MEMBER DIXON: Anybody else? I mean --

PARTICIPANT: Well, does it matter?

MEMBER HAWKINS: One thing you've got to recognize is it does form a behavior pattern. So the ones that know they can do it, they're going to probably do it every month. I see it more in small businesses though than in the big ones.

MEMBER DIXON: Yes, we aren't talking about businesses at all.

MEMBER HAWKINS: Okay. All right.

MEMBER DIXON: This is strictly consumers.

MEMBER HAWKINS: But consumers are going to do it more if you give it to them. They know it's there.

MEMBER BORDELON: Okay. We need to wrap this up.

Sheila, one more?

MEMBER CANAVAN: Just two quick points. In terms of, you know, repeat users and this debt piling up, it reminds me of what the FTC was looking at with regard to mortgage servicing abuse in the Fairbanks case and also the OTS, I think, was looking at with regard to Ocquin.

If a bank continually allows someone to do this, it's very much like these forbearance agreements that the services were entering into with the consumer, which was -- they were unreasonable forbearance agreements because the consumer had no reasonable ability to repay. They were getting too far in.

And this is the same thing. If you're just sinking the consumer in order to strip fees and put yourself ahead of the grocery store and the landlord.

Which is my second point, that lady may be able to pay her landlord today or buy her groceries today. But what about tomorrow, when you're talking about two to 10,000 dollars a year in costs for at least some of the consumers?

It's ridiculous that bankers are merely stripping and stepping ahead of other people in the economy who, you know, deserve to be paid and shouldn't be left holding the bag.

MEMBER HAWKINS: You ask that lady about tomorrow.

MEMBER BORDELON: Okay. Well, I think that wraps up every possible subject. As you can tell, staff had a fine line to walk and I think they did an excellent job of trying to put this thing in perspective and trying to write regulations and all that.

VICE CHAIR PINSKY: And, Ken, you told me this was the boring subcommittee.

MEMBER BORDELON: This is, this is. Thank you.

Agnes?

CHAIR SCANLAN: Thank you very much, Ken.

Now we're going to turn our discussion to the Community Reinvestment Act and Buzz?

MEMBER ROBERTS: Thank you again, Agnes.

The staff put together a very good memo summarizing comments on the pending CRA rules and seeking additional guidance in a few areas. And so we're going to talk about some of those issues today.

Three that we discussed in committee yesterday -- and I may paraphrase this a little bit from the staff's version of it -- what difference would it really make to raise the small bank threshold from 250 million to 500 million dollars as it's proposed in the pending rule? What difference would it make for communities, if any?

Second is the proposed rule would no longer require small banks to report small business and small farm loans. And would that make a difference? How useful is that information really to people?

And third is should banks be denied positive consideration under CRA for lending that's deemed to be abusive under objective and reasonably drawn standards? And further where appropriate, should such loans actually affect a bank's CRA rating negatively?

So those are the issues that we want to focus on in the next half hour and any others in the proposed rule that other members of the Council would like to raise.

But let's start with the small bank threshold and what difference -- would this really make a difference to communities in terms of investments, services, or loans that they would get?

And I would like to ask Debra to kick it off for us.

MEMBER REYES: Thank you.

What I would like to do is discuss with you what I think is some experience and some evidence that says that the current threshold of 250,000 is both appropriate and important.

And when I say appropriate, what I'm talking about is that it has, in fact, motivated changed behavior by the banking community. And in my opinion, improved behavior.

And with this change in the valuation of the banks, there are three areas that would change if we change the threshold for both the service test, the investment test and also the community lending impact that is achieved by this, I believe, the evaluation because I believe it motivates this changed behavior.

To do this, I'm going to talk a little bit about the organization that I run, Neighborhood Lending Partners is a lending consortium that operates throughout Florida. We have 85 bank members. We are also a certified community development financial institution.

Our membership is made up 70 percent of banks that are 500,000 or less. And of that, probably 10 to 15 percent, are less than 250 million.

In looking at the membership, what motivates that membership and what's required. The membership requires two aspects -- it actually requires three aspects. They must agree to a service with the organization. They serve on the Boards, they serve on the loan committees, executive committees directing the organization's activities.

They also are required to make a capital contribution or capital investment that basically is made as a one-time investment in the organization. They also make a commitment to a revolving loan pool. These commitments for the small banks, from the capital side, are 2,500 dollars and 250,000 dollars to the loan pool.

These can go up to 30,000 for capital investment and up to 15 percent of the loan pool they participate in as far as loan pool commitment. The loan pool revolves so it's a one-time revolving commitment that can be re-decided every two years.

What these loan pool funds are used for are community development, economic development and affordable housing lending programs. In looking at this organization and what has motivated membership, when we originally opened, there was a lot of focus on CRA. And we opened with 30 members and this was about 11 years ago.

As we have expanded the membership and the operations of the organization, there is a behavior for when a new member decides to become involved with the organization and that is the size.

Many new members join just before reaching that 250,000 million in assets. And why do they do it just before? Well, it's less expensive and there is a lesser commitment to the loan pool required at that level.

What we have found, though, once they become members and become engaged, that often they up their loan pool commitments. They see the value. In many situations as they become engaged members, they also start doing part of this lending on their own. And referring business also to our organization when for some reason they can't get to the number they need in their bank.

And as a CDFI, we have resources that we can bring to the table to make the transaction work that might not otherwise work. I will say that I think that the large banks or the megabanks, I think as they've been referred to throughout the last day and a half, I think they're doing an excellent job. And I think they have the resources to hire their own staff to out and do this community development lending activity.

But they're not doing all of the work that is being done or that is needed. And I think that the CRA motivation comes through that evaluation of how well they're performing.

And I will say that when you get to the level of what our organization does, we do some of the same work that the megabanks do but we do a lot of that work where we bring in other resources that make transactions happen that would not happen otherwise. And I would say that the banks are motivated, again, by the evaluation.

And there's going to be some discussion today I know as we move on about well what is the quality of the investment and what is the value of the investment these banks are making. I would go back to something the Hubert said in his presentation. First of all when we look at the small banks, many of them are not even -- or I won't say many of them -- those who are not getting a satisfactory rating are in that group across the board.

So now we're going to lower that standard so we're going to have more in that group that may not reach that satisfactory.

But also the quality of the investment, there are some good investments. There are some that aren't so valuable. We talked about one that's like an 800 dollar grant to United Way. Well that does have some value. Maybe not the value we're looking for but I would say that some is better than none, which is what I think we look at when we push this threshold up.

And to further this point, we took a survey of our 85 members and we asked a number of questions about what they liked about our organization and what they didn't like. What they would like us to do differently.

But the number one question on the survey was why do you invest in this organization? And rather than leave it to them to make up an answer, we gave them a number of choices, many that really did strive to say, you know, we're really interested in community development, we're really interested in being good corporate citizens.

But I think you can all guess that the answer was CRA. That was the answer.

And then the last point I would like to make is there is a lot of discussion, and I agree with part of this discussion, is that the impact is more significant to the rural communities than to the urban markets. But I will tell you that there is going to be a serious impact also to urban markets by this change.

CHAIR SCANLAN: Could I just ask a question, Buzz?

MEMBER MORGAN: Sure.

CHAIR SCANLAN: Debra, you'd mentioned in your discussion that megabanks don't provide all of the services and lending within the communities and they don't and they can't. I just wanted to ask the question does your organization promote partnerships with financial institutions? And if so, what's an example of a partnership in your area?

MEMBER REYES: Well, first of all, the main partnership is the membership. I mean 85 banks are members. And that partnership is, you know, the agreement to this so that's the primary -- of our 200 million dollars, that's 75 percent from the banking community.

But in addition to that, we have worked with a number of our members when they apply for the Federal Home Loan Bank for the AHP funding, we actually will do the monitoring of those loans or grants once they are granted to the project that is being developed.

We have -- we have provided technical assistance on underwriting transactions where the bank doesn't -- wants to do the transaction but they don't feel they have the technical expertise and staff. So they outsource the underwriting to our organization.

So those are a couple of examples.

MEMBER MORGAN: Chuck?

MEMBER GASTON: Thank you, Buzz.

I sat yesterday and listened to this whole conversation and don't pretend to be an expert on it so I'm fairly dispassionate and I don't do business with megabanks too often so --

CHAIR SCANLAN: Well, you should.

MEMBER GASTON: -- I don't have a problem with that. And I do a lot of business with community banks so I support them.

Debra caused me to think yesterday about a specific project that I closed just a week ago tomorrow. I closed a 13 million dollar construction loan. And it's got a lead bank, which is a very large bank. And it' has three participating banks. The three participating banks put in three million, two million, and two million.

And I went back and looked to see what size institutions they are. And each one of them about 350 to 400 million dollar institutions. And I thought knowing the three banks and knowing the folks that I deal with there, which of those three did a participation because of CRA? Well, all of them did. There's no doubt about that.

Then I thought a little bit further. If there wasn't CRA, which of the three would still participate? One of them would because of a personal relationship. The other two would not.

So while I don't have a recommendation of whether you raise it to 500 million, I certainly say don't go to a billion. Because I don't know a whole lot of banks in my area who are at that billion dollar level who would even probably talk to me without CRA.

MEMBER ROBERTS: Robin, do you want to get in on this?

MEMBER COFFEY: Yes, I think when staff asks the question, you know, what happens if you raise the threshold here, I said the biggest thing I see -- and both as a banker responsible for monitoring CRA compliance for 29 charters, 25 of which would be considered small banks under this proposed rule change, I can tell you that the biggest difference is becoming reactive or becoming proactive once they get to a certain size.

Banks of a certain size are totally reactive to what walks in their door. And for good or bad, community development lending doesn't just walk into your door. It's something that you create. It's something because you are visible within the community.

Maybe the opportunity will walk in because you're the only bank in the community but that doesn't necessarily get done. A lot of the loans that we're doing through a CDFI in the State of Illinois now are being referred by banks who are uncomfortable lending to non-profit social service agencies but because of CRA, see an opportunity to make an investment in another CDFI and earn credit that way. And then also serve their local community.

The other thing that is not really talked about within the questions but really becomes the main cost involved with moving from a small bank to the large bank test is the component of the test that deals with investments. Lending is not any more difficult in any size institution you're at.

Although community development lending, because it's very specific and loans have to meet specific characteristics, community development lending becomes more difficult or it becomes harder to document or for some banks to find.

But once -- I'm trying to figure out the best way to say this -- banks -- between moving from the large bank to the small bank, the primary difference is when you are a small bank examined under CRA, it's the examiner, it's up to the examiner to prove whether you do or do not comply with CRA. It's up to the bank just to present the data and pretty much walk away.

In the large bank test, the bank has to prove their data. They have to provide additional documentation that they don't provide as a small bank. They have to essentially have to write their own performance, their own CRA evaluation performance. And they have to prove what's out there in the marketplace.

They don't do that as a small bank. So that's really where the cost differential for compliance as a small bank versus large bank is the large bank has to do most of that evaluation on their own.

They also have to make an investment. And a lot of banks, while I've read the arguments that we're in the community, we invest in our community, that's true. However, under CRA, investments that count for CRA are not the purchase of the local hospital bond. It's not the purchase of the road improvements or the school bonds.

It's only -- the only things you get to take credit for are those where you can prove that over 50 percent of the beneficiaries of those bonds or of those investments are low- to moderate-income people.

And that requires additional documentation. That requires a heavy burden of proof on the institution. And that's where the additional costs and the additional burden comes into play because it's up to the institution to prove to the examiner that it is community development.

MEMBER ROBERTS: Tommy?

MEMBER FITZGIBBON: I just want to follow up with -- Robin and I work in the same market. And also to follow up on what Chuck said earlier in terms of participation.

Last year, our loan shop originated 53 million dollars in community development loans. We have 26 percent of Tier 1 capital invested in qualified community development investments and loans. So it is a fairly significant part of our business plan what we do.

I have currently in the stable about 15 other banks, who we shop participations around to, predominantly because they don't have the expertise or the capability or competency frankly to underwrite relatively complex leverage transactions, some of which is real estate, a lot of which is business and job preservation.

And learning that process, I think I consider myself at my age ready to sort of pass on to somebody else the responsibility of thinking how to do community development lending in the Chicago land market. And it's important for there to be that learning experience.

How do you do it? Well, you learn through actual transactions. You learn through participating with CDFIs and learning about the credits, learning how to understand how that capital plays a role in job creation, job stability, affordable housing, things of that nature.

And the time when they sort of come around to the barn is generally speaking at the 225 to 250 million dollar level. Up until that point, they're beating my commercial real estate lending department and beating up my commercial department in their pricing and their strategies for obtaining certain relationships that our bank would certainly like to have.

Only they don't have, frankly, the responsibility to do something different about community development capital that needs to be deployed in the market. So I think that if they're going to play in my sandbox, and I'm going to share my toys with them, they should play by the same rules.

MEMBER ROBERTS: Okay. Hubert?

MEMBER VAN TOL: I think the problem that we struggle with goes to some of the way some of the other problems that I spoke of in my presentation.

I would be less concerned about the threshold, I guess, if there was some requirement that smaller banks have some type of investment requirement in their communities. And, you know, it could be a simplified, a less complex sort of investment test for smaller institutions. I could feel okay with that.

Or I could feel okay with, you know, possible different thresholds if there was more ways of encouraging the smaller banks that are also beginning to look at that.

And if we could at the same time look at the whole problem of LMI geographies in rural areas and try to fix that because there are so few LMI geographies in many rural counties. And if community development can only happen out in some farmer's field somewhere in the back census tract, then it's going to be difficult to do.

And I think we have to, you know, fix the problem in a county of 20,000, 50,000 people, most of the development, community development and investment has to be done in the towns, which are not going to be the LMI census tracts in a rural area.

So I think it's probably a difficult problem to address that issue, to separate out what would be good for rural areas because what I'm suggesting for a rural area I think many of my urban colleagues would fight tooth and nail if it were proposed for an urban area because it probably have destructive CRA effects in an urban area.

So I guess I would just ask that as we work through this, we try to think through some of those other elements of community development in rural areas as well.

MEMBER ROBERTS: Before shifting to another question, I just wanted to build on your comment because we see it a lot in rural areas.

Number one is there are very different rural regions in which the entire region may be economically distressed. But they vary. They're not similar in numerous respects.

The Colonias area around the border with Mexico is very different from rural New England in Maine, it's very different from the upper Midwest, it's very different from -- the Midsouth Delta is very different from Appalachia.

Many things in those areas that would benefit the entire county or community, I think, are legitimate community development investments in many of those places.

But because, as you had pointed out in your earlier presentation, there is much greater dispersal of low-income people and much less concentration that we see in urban areas. It doesn't count and we need to figure out a new way of, I think, getting at that especially in light of a lot of changes in the census definitions so that now the Grand Canyon is part of a metropolitan area which is kind of interesting.

MEMBER FITZGIBBON: I just wanted to say just so that Hubert doesn't think that he wouldn't have support from the urban, I think that there's good opportunity to discuss this because we have DuPage County in Illinois that has one moderate-income census tract and no low-income census tracts.

And so to be able to do something in effect in DuPage County, which is the fastest growing county in Illinois, we don't have the opportunity. So I think there may be more support, Hubert, than you think.

MEMBER VAN TOL: I mean just to hear you mention hospital bonds, I mean in many rural communities, getting participation on a hospital bond might be in a very important community development thing but I would see why urban people would -- or I guess you were the person -- so, you know, I think there should be some different structuring of the rules.

MEMBER ROBERTS: I see we may have stirred up something here. I've got Dan and Bruce.

MEMBER DIXON: The whole discussion sounds a little strange to me as if the only reason to ever do one of these transactions is because of CRA. And if that's the case, I assume what that means is that these somehow are not really investable deals on their own merits.

And, therefore, we need to subsidize them in some way. And the one way to do that is to force banks subject to CRA to do them on a below market basis.

Well, if they really need subsidies, then maybe we should do that more explicitly and allow other people to participate in the subsidizing process then just, you know, nationally chartered banks.

On the other hand, if they're really legitimate deals, I mean most bankers I know like to do deals that make sense.

And so I -- there's a little bit of disconnect here. And at the risk we're not really a rural-oriented company but I'm not sure it's just a rural issue anyway frankly. I mean I think that, you know, the same discussion turns on deals in urban areas.

MEMBER ROBERTS: In fact many of us had heard that same response from banks many years ago with respect to urban areas. If there was something worth doing, they would have done it or been doing it already.

And I think we've discovered through the last couple of decades that that, in fact, was not the case. That there were plenty of investable deals to be done if they would only get started in doing them.

Bruce?

MEMBER MORGAN: Yes, Buzz, in a past life I worked in community development, trying to develop housing in rural and urban areas. And the problems that I had at that time was getting the banks interested in funding the products.

So I changed stripes and became a banker. And when I bought this small bank 11 years ago, the first examination -- we're talking about rules and I think maybe we've gotten astray a little bit from the process that's actually going on in the real world.

Eleven years ago, the first CRA exam I had, the examiner wanted to know low- and moderate-income borrowers that we were making loans to. They wanted to know loans to people of color. They wanted to know what we were doing with organizations in our community. They wanted to know what kind of investments we were making. They wanted to know if we were engaged in any type of community development activity.

Let's contrast that with my last exam. My CRA exam, the examiner came in. I want all of your loans. I want your assessment area. And we're going to do a statistical analysis of the ins versus the outs and we're going to compare that with census data. And that's what we're going to be putting in your report.

I said wait a minute. What about my private urban renewal program to take housing, rehab it, put it back into owner-occupied? You get no credit for that.

Wait a minute. What about me buying the local bond issue for the local college that needs it to survive? You get no credit for that.

Wait a minute. What about my sponsoring community organizations in the affordable housing grant program of the Federal Home Loan Bank to actually build a rent-to-own project down in the central city in my metropolitan area. You get no credit for that.

It's an in and out deal. You are a small bank. And so we're going to apply a different process to you and we're going to give you no credit for that.

Now in our zeal to get data on what's going on in terms of lending, I think we sort of lost what the target was. And if Community Reinvestment Act is really to direct banks to engage in their local communities, then we need to look at the process also and make sure that banks get credits for the practice.

And I wouldn't say best practice because I don't want Forrest to jump all over me.

(Laughter.)

MEMBER MORGAN: Or the trial lawyers. But just get credit for what you're doing. And I think you would be surprised at how you could change behavior if you gave banks credit for things they did in their local communities and encouraged it with the examination process rather than discourage it, which is what the present system does regardless of the threshold.

MEMBER ROBERTS: Since we only have a few minutes left in this segment, I'm going to be autocratic and change the subject a little bit so that we can spend a little time on a very important question which is abusive lending.

And whether the staff's question should banks be denied positive consideration under CRA for lending that's deemed abusive under objective and reasonably drawn standards?

Anne, you want to get in on this, I know.

MEMBER DIEDRICK: Yes. I don't want to bore you but I do want to read just two paragraphs from our five-page letter, comment letter on the proposal.

"The overriding purpose of CRA is to ensure that banks help meet the credit needs of their communities, including low- and moderate-income communities. The current CRA regulations were drafted to evaluate how well banks are meeting those needs. However well intentioned, it is totally inappropriate to overlay the entire structure of consumer compliance on top of CRA. And that includes provisions of ECOA, FHA, HOPA FTC, RESPA, and TILA.

"These are two distinctly different spheres and should be treated as such. With respect to the newly specified acts, each of them has its own compliance and enforcement mechanisms. Each of these laws as passed by Congress at different times to achieve different and distinct purposes. Compliance with each of these laws is already strictly monitored by the agencies during consumer compliance examinations.

"Moreover, FIRREA was specifically enacted to provide a comprehensive framework of regulatory action and enforcement powers around compliance violations. It is not Congress's intent to have the agencies impose the entire consumer compliance examination process into CRA."

Not in my letter says -- I want to say we don't want it to be the Venus fly-trap of all consumer regulations.

"And secondly, and it's particularly troubling is the increasing risk to financial holding companies of having the new powers granted to them under Gram-Leach-Bliley Act taken away because of a CRA downgrade. A bank that currently has a "satisfactory" rating could easily be downgraded to a "needs to improve" for relatively minor violations of one of the consumer protection laws such as the single failure to send a right of recision notice.

"If Congress had intended that a bank's compliance with consumer protection laws could prevent a financial institution from engaging in securities and insurance activities, Congress would have included such language in GLB.

"If adopted, the proposal would greatly undermine the purpose of GLB to allow financial holding companies to engage in a broad array of financially related activities."

So we are very concerned about this additional burden placed on top of CRA when we believe that there's plenty of opportunity in a consumer compliance exam.

MEMBER ROBERTS: I seek your guidance.

CHAIR SCANLAN: One more comment.

MEMBER ROBERTS: One more comment. Sheila?

MEMBER CANAVAN: I'm not well educated or well versed in this area but I'm a bit confused by what Anne has said. If the question is, should banks be allowed to claim credit for abusive loans, and Anne's position is that these matters should be kept entirely separate -- or am I conflating or misunderstanding?

MEMBER DIEDRICK: Maybe I didn't answer the question properly.

MEMBER CANAVAN: Well, just -- it seems that banks are combining these by claiming credit for loans which may be abusive. In other words, if the banks want to keep it separate, then don't claim credit.

But maybe I'm totally confused and I apologize for that.

MEMBER DIEDRICK: Yes, I may be, too. I may be, too, because I believe under the current CRA, if during the course of the fair lending examination there is a violation that is found of an abusive lending practice, that already factors into the CRA rating today. You don't have to change anything.

MEMBER ROBERTS: Well, I do believe the question that the staff asked for guidance on was should a bank continue to get credit towards CRA for loans that are abusive?

MEMBER DIEDRICK: Continue?

MEMBER VAN TOL: Well, that sort of depends on what the definition of abusive is there. I think Anne is using the definition is if it's illegal, this is what would happen in a fair lending exam, right?

But from a consumer perspective, there are many loans that we consider -- for instance, if your bank shows that -- if an analysis shows that all of your sub-prime loans are going into minority neighborhoods and your prime loans are going into white neighborhoods, there's probably no easily provable violation of the law there.

But from our perspective, there ought to be some hit on your CRA exam for doing something like that. And you ought to be focusing just as much in your prime effort at minority communities as your sub-prime effort.

So I think that's what we were trying to get at with this kind of proposal. And I don't know what the -- you know, how the Fed staff understands all of this.

MEMBER ROBERTS: Well, regrettably, I think we have to turn this back to Agnes.

CHAIR SCANLAN: Unless, Sandy, you'd like to provide a brief clarification?

MS. BRAUNSTEIN: Well, I think -- I mean there's a couple different issues here. There's Reg B issues if there is discrimination involved. And then there's CRA issues, which is what this proposal was getting out.

And the proposal was basically geared at one of the things we were hearing from community groups is that banks that were taking credit for loans that their affiliates made in low-income neighborhoods, that it was possible that some of those loans that they were getting CRA recognition for may have been predatory in nature.

And that could mean various different things. It didn't have to do necessarily with discrimination because that would be handled through Reg B. This had to do with whether or not these loans were predatory in terms of having characteristics of abusive loans.

So in the proposal, there was some attempt to try to clarify and define what was meant by possible predatory loans. And to make sure that banks were not given recognition for making loans in low- and moderate-income neighborhoods or to low- and moderate-income people that were abusive. That they were not getting CRA credit for that.

CHAIR SCANLAN: Thank you, Sandy. Thank you very much.

Thank you, Buzz, for leading that discussion.

Right now we're going to go to committee reports where the Council Chairpersons on the different committees will talk about the work that was done yesterday in the committees and the topics for the next meeting.

Please keep your remarks brief so we can keep on time. And I'll start with you Janie, Community Affairs and Housing.

MEMBER BARRERA: Thank you. Along with the foreign bank remittances, we talked about the fiscal impact tool. The staff made an excellent presentation on the use of the tool, and the potential impact of what that tool would have on economic development for certain projects in different parts of the country.

We also had a great report from Jeanne who talked about the Financial Literacy and Education Commission and what their strategy is to promote this. And we thought that she did such a great job we want her to come back at the next session to give us an update on the progress that the Commission is doing.

Also for the next meeting, we would like to -- an OCC Preemption presentation by the staff on the authority of the Fed to examine mortgage lending subsidiaries. And regarding HMDA, we would like the staff to report on that the effects of the changes in census will have on the LMI census tracts and how will the pre-2000 census HMDA data be compared to the new HMDA data.

CHAIR SCANLAN: Thank you, Janie.

Ken, Depository and Delivery Systems?

MEMBER BORDELON: After the dust settled on bounce protection, we tackled Check 21. We had a briefing from Fed staff from Jack Weldon on the comments received to date, approximately 350 he reported comments, and basically supportive of the implementation tactics that the Fed is taking to implement Check 21, which has an implementation date of October of this year.

Then we got into an analysis of the debit card study that has been given to the Board by some members of the Senate. Comments are due there by the end of July. That's basically taking a look at the imposition of fees for PIN-based debits versus signature debits. And we should get a follow-up report on that at the next meeting.

And finally we did not have very much time and we'll have to bring that up at the next meeting on EFT, Reg E for recurring debits that were brought by some of the merchants looking for clarification as to whether a recorded authorization will suffice in lieu of a written authorization for recurring debits on debit cards versus credit cards since debit cards are being utilized more and more by the consumers.

So for the next meeting, we'll have a carry over for Check 21. We should tackle the ID theft portion of the FACT Act, continuing discussion on the EFT provision on recurring debits.

Hopefully we won't have bounce protection to talk about anymore and we may have time to take the E-Sign Act discussion up.

CHAIR SCANLAN: Thank you, Ken.

Consumer Credit, Dan?

MEMBER DIXON: Thank you.

The committee dealt with a couple of issues under the regulations that are required to be issued under the FACT Act. First of all, we spent a few minutes talking about pre-screened applications. The Fed is embarking on a study of whether or not the consumers have adequate opportunities to opt out.

We didn't have hard data but there is concern that pre-screened applications and other direct marketing solicitations, for that matter, increase the risk of fraud and identify theft.

On the other hand, it's also clear that many consumers benefit from that type of marketing. And there are, in place currently, a number of channels and opportunities for consumers to opt out of direct marketing and pre-screened applications.

We are not aware, as a committee, of any particular methods that are available at the state level, separate and apart from the federal credit bureau and institution-direct opt-out opportunities.

We also talked about notices that will be required. And the Fed is working on regulations for notifying customers about credit decisions, risk-based pricing decisions based on adverse credit bureau reports.

Everyone on the committee is very interested in seeing how the Fed staff will define material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that lender. And since that hasn't been defined yet, our conversation was fairly general in nature.

And finally for the FACT Act, there are notices for affiliate data sharing and use of marketing information that are pending. And as was mentioned earlier, there is a concern as the regulations for those notices are developed in the context of the statutory requirements, that the staff carefully consider conflicting scheduling requirements from, for example, these notices as compared to the Gram-Leach-Bliley Act privacy notices, which we have to send out once a year.

We also spent time on the overdraft loans, overdraft bounce protection services but I think that's been summarized adequately.

And then finally we talked some about debt cancellation and suspension agreements and whether or not they are covered under Truth in Lending and APR calculations. And I think the general consensus in the committee, fortunately, was that debt cancellation and suspension agreements should be treated similarly to credit insurance.

And secondly, if there is a substitution of debt cancellation or debt suspension in lieu of credit insurance, then customers should have an opportunity to affirmatively agree to that substitution.

For our next meeting, we have a carryover item for discussing sub-prime securitizations and their coverage under CRA. We're not quite as sure as Ken is that the overdraft service will be resolved satisfactorily so that's a potential item.

We understand that the Fed staff is working on an advance notice of proposed rulemaking dealing with open-end credit and how that's treated under Reg Z and Truth in Lending. So that will probably be a subject for us.

It seems that the FACT Act will be on the agenda for maybe the rest of our lifetime. And finally we have, within the committee, begun to negotiate the terms under which we might have a discussion about Federal Anti-Predatory Lending Law.

CHAIR SCANLAN: Thank you, Dan.

Buzz, the Compliance and CRA Committee?

MEMBER ROBERTS: Yes, in addition to EGRPRA and the CRA issues that we have discussed today, we also had a clarification of the post-merger enforcement and monitoring of CRA commitments. We also discussed some issues the staff had proposed with respect to CRA treatment on the investment test. And talked about the disparate impact theory of credit discrimination with respect to ECOA, the Equal Credit Opportunity Act.

For next time, we expect that there will be some new EGRPRA issues for us to consider. If CRA is still open, we would expect to spend more time talking about the CRA pending rule.

And we'd also like to join with the Consumer Credit Committee to talk a little bit about this question of the securitization of predatory lending and its relationship to CRA.

CHAIR SCANLAN: Thank you, Buzz.

Before we adjourn for lunch, I'd like to thank all of the Council members for your participation not only yesterday but for your robust discussion today.

Also I'd like to thank Ann Bistay, Tina Featherstone, and Jean Durr for all of the organization and all of the work that you did in the planning of this meeting. You all do a great job and we really appreciate everything you do.

I'd also like to thank Sandy for your leadership and Adrienne Hurt and Terri Johnsen for all of the work that you do with your staff and the rest of the staff of the Fed. The preparation and the materials that are forwarded to us, and particularly this time with the very targeted and strategic questions and the focus really helped our discussions yesterday. So thank you all very much.

And we are moving into lunch, which is just right down the hall. And we're adjourned. If you have not picked up the large envelope, there's a large envelope outside to help you mail your materials back to your respective homes.

And have a safe journey. Thank you very much.

(Whereupon, the above-entitled meeting was concluded at 1:00 p.m.)