TRANSCRIPT OF THE

CONSUMER ADVISORY COUNCIL MEETING

THURSDAY, MARCH 17, 2005

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., Mark Pinsky, Chair, presiding.

Members present:
Mark Pinsky, *Chair*
Lori R. Swanson, *Vice Chair*
Stella Adams
Dennis L. Algiere
Faith L. Anderson
Susan Bredehoft
Sheila Canavan
Carolyn Carter
Michael Cook
Donald S. Currie
Anne Diedrick
Dan Dixon
Hattie B. Dorsey
Kurt Eggert
James Garner
Deborah Hickok
W. James King
Elsie Meeks
Bruce B. Morgan
Benjamin Robinson III
Mary Jane Seebach
Lisa Sodeika
Paul J. Springman
Forrest F. Stanley
Diane Thompson
Anselmo Villarreal
Clint Walker
Kelly K. Walsh
Marva E. Williams

Others present:
Sandra Braunstein, Director, Division of Consumer and Community Affairs
Edward Gramlich, member, Board of Governors
Susan Bies, member, Board of Governors
Ben Bernanke, member, Board of Governors
Roger W. Ferguson, Jr., Vice Chair, Board of Governors

A G E N D A

P R O C E E D I N G S

CHAIR PINSKY: Good morning, everyone.

Welcome as we convene the Consumer Advisory Council for this year.

I want to first just start by welcoming everyone, welcome returning members, and welcoming new members. And let me, if I can, just sort of formally welcome the new members who joined us this year. I think there is a great group with a great mix of views and perspectives and knowledge.

Stella Adams from the North Carolina Fair Housing Center; Faith Anderson from American Airlines Federal Credit Union--I'm not going to get oriented where everybody is--Carolyn Carter from the National Consumer Law Center; Mike Cook from Wal-Mart; Don Currie from the Community Development Corporation of Brownsville; Kurt Eggert from Chapman University School of Law in California; Debbie Hickok from ACH Commerce; Lisa Sodeika from HSBC--Lisa, hi; Anselmo Villarreal from La Casa de Esperanza; Kelly Walsh from Bank of Hawaii; and Marva Williams from Woodstock Institute. It's great to have you here, and we look forward to what we know will be a terrific discussion.

Very briefly, I just in welcoming everyone, I want to ask Governor Gramlich if he'd like to say a few words to us.

GOVERNOR GRAMLICH: Thank you very much, Mark. Many people have stopped me around the room and asked me how I'm feeling.

I was in the largest city in the world just a short time ago--roughly a day. But I can't--this is Chongqing in China--it's now a city of 32 million people, and I've--I knew this meeting was happening today so I hastened back to get to it, and as you see the agenda, we have a very lively session.

This committee is my favorite Board advisory committee. We have a number of them, but this is the only one that has the people from all sides of an issue sitting around the table. We have bankers and community advocates and everything in between, and so the discussion is a lot more heterogeneous than we often get from our other advisory committees, and it certainly makes it more fun for us to have you disagree with each other than to have everybody banging on us from one side.

(LAUGHTER)

And to go along with that, the consumer issues are inevitably very complicated and delicate and so we always have very good discussions, and if you just look at the agenda for today, I'm sure that it will be the same today. And so I'd like to add to Mark's welcome. These committee meetings are very helpful for us here at the Board, and we look forward to getting your advice and having a good meeting. Thank you.

CHAIR PINSKY: Thank you, Governor Gramlich. Let me also thank Vice Chairman Ferguson for being with us today, and Governor Bies and Governor Bernanke. It's very helpful for us to know that our disagreements are being heard, right? Or at least that when we disagree with each other it gets out of the room that we were in, you know. It's a little broader than that.

And also extend my thanks to the Fed staff. I think we would all agree it's an honor to serve on this Council and the staff--Sandy, you and your entire team, and too many for me to identify, do an extraordinary job of getting us ready and framing the issues and providing the research so that I think we feel like we can come in and have lively discussions, informed discussions, and hopefully contribute to the work of the Board.

I also want to thank the committee chairs who led us through some discussions yesterday and will lead us through discussions today. I thought that I would really quickly run through the agenda, just so we all know what we're going to try to cover today. And then we'll come back and we'll get started.

So we are going to--our first discussion today is going to be a discussion organized around the guidance that we as the CAC can provide for lenders and consumers about the release of the new Home Mortgage Disclosure Act data that will be sort of pouring out very soon. And Mary Jane Seebach is going to lead us in that discussion, and that was a topic that got discussed in two committees yesterday so we'll have a lot of views to start with.

We're then going to turn to Forrest Stanley from Key Bank is going to lead us in a discussion of the Electronic Funds Transfer Act, which we discussed yesterday as well.

We'll have a brief break, and we'll adjust that depending on how the time goes--we're aiming for 10:45--and come back and have an hour-long discussion of the Community Reinvestment Act, and Anne Diedrick is going to--who chairs the Compliance and Community Reinvestment Committee--will lead us in that discussion. Plenty to talk about there.

And finally we will talk about the Truth in Lending Act and Dan Dixon -- where are you, Dan? Right there. Dan will lead us in that discussion.

About 12:30 we're going to have a members forum presentation. We try and have a members forum presentation at each of our meetings so we can all learn, and the governors can learn a little bit more, about some of the work that some of us do. And I'm extremely pleased that Bruce Morgan from Valley State Bank is going to do a presentation on community banking, which will be terrific.

At about 12:45, we'll do -- we'll ask each of the committee chairs to report on some of the other issues they talked about, and particularly what issues are coming up that we'll be looking at--we may be looking at going forward as we plan our agenda for June and even looking ahead to the fall.

So if there are any questions from Council members about the agenda--does that seem right? Great. Mary Jane, I'm going to turn it over to you.

MEMBER SEEBACH: Thank you. Good morning everybody.

Effective with the collection of 2004 HMDA data, lenders are now required to disclose limited pricing information about the loans they originate. The submitted data reports the difference, or the spread, between a loan's annual percentage rate, or APR, and the yield for comparable Treasury securities.

The Board adopted a threshold of 3 and 5 percentage points for first and subordinate lien loans, respectively. The spread information is intended to allow the Board and the public to learn more about nonprime loans and also provide valuable information in fair lending enforcement.

Data will be released by lenders to individual requesters on or about March 31st. The aggregate data, however, and analysis from the Fed, will not be available until September 1st. In between, lenders, consumers, activists, and the media will begin to struggle to understand what the new data really means.

It's clear from the early press coverage that some lenders are concerned about the potential legal and reputational risks that will accompany the release of the new data. Others are looking forward to the release as an opportunity to enhance the review of lending activities and to also allow them to identify markets with relatively large numbers of higher-priced loans where entry may hold profit opportunities for lenders and increase competition for consumers.

The data, however, has some inherent limitations in that it does not include many of the legitimate factors lenders use to determine prices. Use of the data on its own to draw conclusions about discrimination is problematic. The topic for today is to discuss what information can help us make best use of this information now.

First off, I'm going to divide this into three different areas that I'd like to have us discuss. From the consumer's standpoint, there needs to be more transparency between price and credit risk. How do we better educate consumers on understanding their credit history and how it will affect the price?

Also, how do we motivate consumers to negotiate price in markets where consumers have not previously negotiated? The second aspect will look at what the lenders role in this is. We need to discuss what steps need to be taken to ensure that financial markets are giving all consumers the same product options.

How do we ensure products are fairly offered to similarly situated borrowers? And finally, how can the Fed help this process to ensure that lenders and activists take advantage of the new analytical opportunities to ensure there is fair pricing in the market?

So I'd like to start off the first part of the discussion with a look at consumers and what we need to do to better educate consumers, understanding the link between their credit history, their credit score, and the price of the loan they're going to receive.

Anyone?

MEMBER ADAMS: Okay, I'll be first.

MEMBER SEEBACH: There you go.

CHAIR PINSKY: We were betting Stella would be --

MEMBER ADAMS: I think while it is important for us to educate borrowers about their credit score, their credit history, the role of credit in pricing, we can't allow the data--the HMDA data, to get ahead of itself in that regard.

In my opinion, from my anecdotal experience as a activist on the street, that's what happened with the '95 data or the '92 data when it came out. There was a big talk about, well, the credit is based on the difference in the racial, ethnic performance was based on credit risk. So we ended up with a large number of people who had--who were eligible for prime loans assuming their credit was worse than it was, and ending up in the subprime market, and often ending up in predatory loans, because the educational message that got out was incomplete.

So we need to make sure this time around that we make sure that whatever consumer educational materials we design is a complete message that not only says to new first-time participants in the market that your credit influences price, but also tells them how much it influences price and what they can do to improve their credit, and also to inform people that their credit is not as bad as many people think.

If you think that your credit risk is such that your credit requires eight, nine points above prime, you're not ready, one, for a mortgage, and two, I don't know that risk really compensates for that.

And that is all based on risk. And so we can't just say to borrowers, well, your credit influences rate and not explain to them what that proportionality is--what they should be assuming about it. Access to credit scores without letting people know what the credit score is normed to--that if you have 680 and above you should be getting the best rate. Or a 620, you should be getting a little bit higher rate. If we don't do full and complete education, we will mislead people into higher-rated loans that they're entitled to by their credit risk.

MEMBER SEEBACH: Thanks, Stella.

MEMBER SODEIKA: Yes, we had a very lengthy and good discussion on this yesterday, about also the importance of balancing that education and consumer education. There are so many advocate groups doing a lot of good work in that area. There are a lot of lenders making massive investments in credit education so that consumers understand why it is important to know their score, and what that score might mean. But all of that education has to be balanced with good lender practices as well.

We talked a little bit about this issue of do borrowers know they might be able to negotiate their rate? So that's a piece of education, but at the same time, many of the lenders have good referral programs, so if they are a prime institution, they drive their consumers to a prime network if they know that they are prime. Some of us, as well, have those prime products available within our nonprime network so that regardless of who comes to you, they get the loan that fits their credit and their needs.

But making sure consumers understand that they have these choices is key. And we also talked a little bit about, you know, how do we make that impact? There are a lot of investments going on, but how do we get consumers excited about learning about these things? Getting consumers into a workshop on a Saturday morning to learn them.

But there has to be a good balance struck, certainly.

So we talked a lot about the answer is not always in education. And that the lenders need to really take a proactive role in making sure those choices are made available and known to consumers as well.

MEMBER DIEDRICK: In addition to your committee, the Compliance and Community Reinvestment Committee also discussed HMDA. If fact, we discussed it for well over an hour. And we were fortunate enough that Glenn Canner and Bob Cook both joined us in the discussion. Glenn Canner talked about the regression program that he and his team will be putting every single LAR of every single reporter in the country in this regression program.

And the results will be provided to the regulators of each of the banks, including HUD, for the independent mortgage lenders that they are responsible for monitoring. This regression program will put the LAR information through screens, and, of course, they'll be looking for some statistically different flags that can come up.

So right away this data will be analyzed, and the results will be provided to the regulators. Obviously, this is a great tool to help in fair lending examinations; it's a great tool to help in enforcement, but the HMDA data can identify certain differences in how loans are made in price, but it's not designed to explain why.

Our committee also did touch on the other factors that might impact pricing, including shopping for the best rates and also negotiating, things that won't necessarily show up in the LARs.

MEMBER SEEBACH: Sheila.

MEMBER CANAVAN: In terms of education, I think it's very important to educate or re-educate borrowers that actually they're entering a marketplace because despite, you know, all of the advertising we see on TV and so forth, I think many, many consumers and particularly elderly consumers and perhaps students who are coming into the marketplace don't understand that they're entering a sales culture.

And I think that it's very important for creditors to be more transparent or honest and disclose by properly identifying people on their business cards as loan salesmen, for example. The industry is still using "loan officer" or "loan counselor," and I think that those are misleading and tend to make the consumer think that they're entering the culture that we had thirty or forty years ago, which is very different.

So I think it's very, very important that the industry be straight up and in all of their materials that they give to consumers in their business cards and so forth to say, you know, this is a sale, you have to negotiate. If people know that they're entering an automobile dealership, they know that you negotiate. That if they don't negotiate they're going to get hurt.

Now I say that knowing that my dad once bought a red and white Plymouth Duster off the floor and didn't ask for a dollar off, so you're never going to be able help somebody like my dad, but he is the exception--he is the exception--to the rule. So I think that, first of all, if we can just start there and let people know that this is a sales--a place for sales, and they're being sold the loan. It's not a gift. Then we'll go a long way in that direction.

With regard to the Fed's responsibility in terms of education, in terms of HMDA, and people probably remember that last year at our March meeting I urged the Fed to amend the regulation for HMDA to include reporting of age and this was something that was entirely uncontroversial in our committee meetings and I think many lenders here today will support me in requesting this. This information is captured by lenders, and it's a de minimus cost to actually report on it, and in our committee meetings yesterday I was alarmed to hear that the research department apparently does not consider predatory lending in elders a significant problem.

So I think that since the elderly may have different needs in terms of how they must be educated about the marketplace, I think it's important for the Fed to start, particularly since it has responsibility for enforcing ECOA, which includes age as a criteria for discrimination, to immediately take action and require lenders to report the age of the borrowers.

MEMBER SEEBACH: Marva, and then Kelly and then Stella.

MEMBER WILLIAMS: I wanted to follow up on Sheila's first point about the importance of education, and I think that it's particularly important because in terms of the context between lenders and borrowers, most contacts between subprime lenders and borrowers are actually initiated by the lender and not by the borrower. And so I think that that role of education is particularly important given that context.

In addition to that, I think that it's also, I think, a real lesson to mainstream financial institutions about marketing and outreach in lower-income and minority communities, the kinds of outreach and marketing that are effective there are more personal, one on one, door hangers, phone calls, etc.

And I think that if those techniques are used more often by mainstream financial institutions, that it could be very effective in cutting down, reducing, the number of subprime or predatory loans.

MEMBER SEEBACH: Kelly.

MEMBER WALSH: I think we have a great opportunity this year, particularly, with the implementation of certain provisions of the FACT Act and the great work that bankers and the agencies are doing to educate consumers about protecting their identity to help--to educate consumers to help them make the connection between the credit score and the price of credit. And I think that needs to be done very directly. I think it would be good for the Board to include it in its consumer education materials because I'm not sure that lenders are necessarily incented to do so right when they're, you know, working with the borrower and explaining what the particular interest rate that's going to be offered to that borrower is.

I think that we should be very, very clear that the price of credit is directly related to the credit score.

MEMBER SEEBACH: Stella and then Diane.

MEMBER ADAMS: I want to say that negotiation on loans is not what the norm in the marketplace is. Consumers are not going in and negotiating the price. When they go in, they're told, they ask, how much credit can I afford? And they are told an interest rate, and they are told an amount that they can borrow. In my testing experience we've tested--I've been doing lending tests for ten years on a two-year cycle--hint, hint--next year, lenders.

On a two-year cycle, regularly, of lenders for ten years. And I can tell you that when my testers are trained, they are not negotiating credit. They go in and many times, not the majority of times, but what is a consistent number that has come up in most of the testing that HUD has done and other agencies have done, it's around 20 percent to 25 percent of the time. They're given different interest rates on the loans. And they didn't negotiate that.

Now I will tell you that in one market that we tested, in Miami, the Hispanic tester actually got the better rate than the control tester, but in most cases, in other markets, it was different. And they didn't negotiate these rates; they started out on an uneven plane.

Testing reports and studies that have been done by the Urban Institute, by the Department of Housing and Urban Development, all indicate that borrowers with similar characteristics that go in on pre-application testing are given at some significant level different information about products, different information about terms. And this is not negotiated, and so I don't want us again in a consumer education mode to say to the person well you're just a bad negotiator and that's why you're getting there.

If I walk in the door and you offer me a loan at 7 percent, and Paul walks in the door and you offer him the loan at 6 percent, and I negotiate down to 6 1/2 percent, I still was treated differently. And that's what happens in the real world. And so I want to make sure that negotiation--that we don't put all the burden on compliance, all the burden on the borrower.

The lending institution has an obligation under the law to give equal terms and equal conditions to similarly situated borrowers.

MEMBER SEEBACH: Diane.

MEMBER THOMPSON: I think it's important for us to be clear about what the legal and reputational risks that lenders are concerned about is. And I think that risk is that the HMDA data is going to show very clearly on a wide scale, for the first time, that African Americans are getting loans at higher prices than white borrowers.

And undoubtedly that there are many reasons for that, but I think that fundamentally that is a troubling problem. In our conversations yesterday, I think we had widespread agreement that that is going to be a problem for this country if people understand that the kind of loan they get is based on the color of their skin and nothing else.

And we need to find ways to address that gap, and not simply explain it on the basis of what may or may not be objective criteria. There's been lots of data over the years that African-American high-income borrowers are much more likely than white high-income borrowers to end up with subprime loans. Now of course that doesn't tell you the credit score, but it is suggestive that it is not--as Stella's testing is suggestive, that it is not simply the credit score that's driving where people end up.

Even if it were just the credit score, there are lots of problems that people have talked about over the years about the ways in which the credit score perpetuates historical discrimination in the lending market. So even these purportedly objective criteria can have embedded within them the legacy of historical discrimination. And so one of the things I hope that all of us do that the Fed does and that lenders do and that community activists do is as we peel this back, we don't just put the responsibility on consumers, we don't pretend that this is a race-neutral environment, we ask lenders to continue their outreach, and we work together to try to find ways to close that gap.

Because as long as we have that gap, whatever the sources of that gap are, it's going to foster and perpetuate mistrust of standard, mainline lending institutions. And it's going to perpetuate the impression that many people have, many African-Americans, whether they are low income or high income, that they are not going to get credit on the same terms, that they do not have good credit, and that they do not have access to credit in the same terms as white Americans.

So I want, as we move forward, not simply to try to talk about well we should look at this objective criteria and we're going to try to strip out race. I'm not sure we can do that. Even if we could do that, once we do that, if we're still left with a gap, we have to address that gap because otherwise we are going to re-create that gap going forward because people will just assume that they're not going to be able--they are not creditworthy.

MEMBER SEEBACH: Jim.

MEMBER KING: One of the things I find working on the ground is that people who get ripped off, for lack of another word, are those people who don't believe they have good credit and are just glad to get the loan. So you walk in the door and you ask for a loan and they say okay, it really doesn't matter the terms, it really doesn't matter the interest rate, they're just glad to get the loan, because they read a month ago that African Americans cannot get a loan in the city or by a bank. They've read that if you do, your score must be higher than a point--but they don't understand that. So they just ask the question, can I get a loan?

And the banker says, yeah, I give you a loan. The car dealer says yes. They’ve learned to negotiate price down on a car, but they've not dealt with the interest rate. So if you pay $3,000 on interest and then go up four points or three points, what--you haven't saved anything.

We find that people come to our--to buy homes--they come asking those kinds of questions, still. After all this education, all this reading, they still don't understand because they've never engaged in the process until they've made the decision to buy. They've read the material but it didn't sink because it wasn't applying to them at that time.

So until they've made the decision to buy something, the problem they run into, whoever comes through the door first tend to drive them. If it's a broker I can get you a loan. If it's a banker, not make you a loan because of these kinds of things, so therefore you can talk to me only. So therefore they've got a captive person.

They come back and say I got a deal for you. And so this educational process is important, but I think it has to be marketed to the person that really needs it in anticipation of the fact that they will at some point in time buy. And that's kind of hard to do but in our neighborhoods, that's what we have to do to get people to get into the marketplace.

MEMBER SEEBACH: Elsie.

MEMBER MEEKS: You know what we're always talking about and what we're always looking for is how we balance lender responsibility with consumer education, financial education, and consumer responsibility. And I've been on this Council two years now, and it's almost like it's rhetoric in some ways because when we look at the bankruptcy bill that was just passed, and this is really an important topic now, especially because of that, when there wasn't any balancing that the lender's, the consumer's really going to be a lot more at risk and so this is much more important--and when we also--you know--if you try to balance aggressive marketing tactics of lenders against, you know, how can we possibly as financial educators market in that same way. It just isn't possible.

So I do think that's the Fed's responsibility to increase that and give more guidance to lenders, you know, in light of the bankruptcy bill.

MEMBER SEEBACH: Yes, Susan.

MEMBER BREDEHOFT: I agree that banks and consumers need to work together to resolve this issue. And there is obviously tension between the banks and consumers. And sales reps want to make as much money as they can.

And an educated consumer wants to get the best price that they can get, but there is a lack of education and/or confidence on the part of certain consumers, so it is important that the issue be addressed from two sides and right now what the aggregate data will show is speculation because we really haven't seen the aggregate data.

So as banks we each know what our data tells us. And it's important for us to review that data, analyze it, and, if necessary, make policy and procedural changes to make sure that all people are treated fairly.

I agree with, I believe Kelly mentioned the FACT Act, and this will give consumers greater opportunities to know why they are being treated differently because the FACT Act expands the definition of adverse action beyond pure denial, so if you receive less favorable terms as an applicant under the FACT Act of a certain situation, banks and other lenders need to disclose these reasons to you.

So I guess basically what I'm saying is I'm encouraged by the additional data that will be available to us to use in an industry that will give us an opportunity to work better with community groups to ensure equal treatment for everybody.

MEMBER SEEBACH: Thank you.

MEMBER ANDERSON: I'd also like to add that under the FACT Act there has to be a financial literacy commission, and I believe a lot of our financial institution regulators are on that panel, and they also just came up with a web site, and I know that, you know, from the community point of view and all the not-for-profits you could stress that.

And also, you know, remind them that they can get a free credit report, and also, I realize it's headed by Treasury, I believe, but you know since it's free to work with them so that you don't have to spend all the money again to re-create the wheel when there is something there that we can all use.

MEMBER SEEBACH: Before I go to Hattie, I just wanted to say yesterday, apparently, the GAO released its study that was mandated by the FACT Act, and I don't know if folks saw this, but it was just sort of interesting.

They were -- it was a study of 1,578 consumers. Sixty percent of them had seen their credit report. One-third of them got a score, 18 percent of them disputed inaccuracies. Ninety-five percent of the sample knew that their credit history can affect their ability to get a loan. It doesn't say that they understood the correlation to price, but they knew it affected their ability to get a loan. Eighty-seven percent knew that late credit card payments could negatively affect their score. Ninety percent knew they could dispute information on the report, but only 28 percent of them knew that they could get the credit-reporting agency to correct it for free. I thought it was sort of interesting.

So consumers clearly know the credit report is out there. I think the word is getting through to them. There is still the correlation of how that credit--they know it may affect whether they can get a "yes" or a "no" on the loan, but I don't think they get the next step which is it can also affect the price on it.

GOVERNOR GRAMLICH: Well, I just wanted to say one thing. Sheila raised an issue about age, and a lot of you have raised other issues about other fields of information such as the credit score that might be required. We, in making regulations for HMDA, we have a problem that when you require something, you've got to be careful about how much you require, and plus there are a lot of steps, and things have to go out for comment, and then they get discussed, and it takes a long time.

So we've been a little, I suppose, conservative on what we actually require under HMDA. But for those of you who think that other information might be helpful in interpreting the data, there's nothing to prevent the lender from making available that other information. That can be done in various ways, and so there is a difference between requiring something and just letting it become available. So some of you might keep that in mind.

We have to be a little careful on exactly how much we require. I mean to require age, for example, would be a lot of additional information and could be--could be somewhat costly. But, if age is relevant a lender could make that information available if it--if the lender so chose.

MEMBER SEEBACH: Hattie.

MEMBER DORSEY: I just wanted to back up a bit of what Stella and others were saying, but I wanted to add location with reference to the HMDA data reporting. Location makes a difference based on where the branches are located, and regardless of whether or not the credit scores might be the same, the pricing is going to be different in a minority community versus a majority community, even though their income may be of the same level.

You know, we have very high-income minority communities and we have very high-income majority, needless to say, but I would bet that the data would reveal that there is a price difference going on there. So I would like to include the location piece to the conversation, which we had on yesterday.

MEMBER ALGIERE: Just a comment. Banks have and continue to provide financial literacy education to consumers and banks do spend a significant amount of resources in that. However, there are places we can improve, and that's where bankers and banks need to work with the various community groups in their areas to identify those areas and work and do a better job.

Secondly, the data is going to become available--that data is going to be available to the regulatory bodies, and I'm confident that the regulators and examiners will go in the bank and financial institutions and if there's any hint of any discriminatory practices that they will address that. But I do encourage banks to work with the community groups. If community groups have questions on data, bankers should sit down with the community groups, go through it, because there could be some circumstances which need to be further explained as to why numbers are such, and I certainly feel that the bankers should make the groups and the population, the constituency out there comfortable with that data.

So there has to be communication and if there's areas that banks that need to do a better job, we certainly want to hear that, but I do want to emphasize the fact that banks have spent a considerable amount of resources over the years in trying to do that, educating the consumers and helping them better understand the process, which in many cases is very unique and it's a first time experience for a customer to go into a bank and apply for a mortgage and it's something that is a very difficult experience at times for some people.

MEMBER SEEBACH: I'm going to slightly segue but I think, I mean, it all is relevant but into the issue of ensuring the similarly situated borrowers are given the same options, one of the discussions that we had yesterday, and it’s been touched on a couple of times today is in the--the bad players, if you will, in the subprime market use credit score education, if you will, to a negative way. In other words, we heard yesterday that sometimes they make the consumer feel guilty and just glad to get a loan.

A lot of people are saying that maybe we should have the loan officer make--using the credit information in more of an educational way to educate the consumer about the options available. And I wanted to see if we wanted to discuss that a bit more about the actual--in other words, I think Marva, you touched on it. I mean it's the actual interaction between the loan officer and the individual borrower. It's not sort of the institution and the borrower--Dennis, you want to follow up?

MEMBER ALGIERE: I think Marva brought up a good point regarding prime lender and the subprime lender--it's important that the customer going from the prime lender to the subprime lender understands where they're going and what it involves. That was a very good point you did bring up.

MEMBER SEEBACH: Diane.

MEMBER THOMPSON: I want to build a little bit on what Dennis just said, which is that for most consumers, a home secure transaction is a fairly unique transaction. No matter how much education, community groups, and lenders do, the consumer is always going to be at a structural disadvantage entering into that transaction. There's no way that they're going to be educated on all of the pricing mechanisms, on all of the loan products available, on all of the factors about their credit score. It's just not possible. This is a transaction that most of us do only a few times in our lives. Loan officers do several everyday.

There's not ever going to be a symmetry of information there, which raises--makes very clear, I think, one of the points that Lisa made earlier, which is that assuming, for now, that the HMDA data does show a gap, it's going to stress again the importance of honesty and fair dealing by lenders.

Sheila talked about transparency, about having loan officers be called loan salesmen instead of officers. There's lots of data that show that most people when they go in to get a loan they think that the bank is going to just give them the best loan that they're entitled to. Now we can do things to counteract that, but we're never going to be able to get the consumer to the point that they can really be an effective negotiator on all of the terms of that.

So we need to have lenders be honest and transparent in their dealings as well as the point that Marva was making about the importance of lenders, particularly of prime lenders, doing significant outreach to underserved communities.

MEMBER SEEBACH: Forrest.

MEMBER STANLEY: I was actually going to comment on one of the earlier issues, but just--there was a comment about rhetoric, and I agree--I think it was Elsie's comment. I'm a little bit afraid that we're, in an effort to take one step forward; we're going to end up taking two steps backwards.

The purpose of the new HMDA rules is to provide transparency, also to give lenders, regulators, activist groups more tools. But over the last years, I think we would all agree--and by the last years I mean the last ten years or so -- I think lenders and community groups have worked very well together. We absolutely have differences from time to time, and I think the numbers are going to show that there are problems that banks are going to have to address, but I think we will lose here if we don't continue to communicate, and this is kind of a gotcha moment.

And I am concerned about that, and I think lenders generally are concerned about that. I mean we need to continue the dialogue; we're going to have to agree to disagree sometimes, but I'm the first one to admit that bankers need to do more, and the data will show that in some cases.

MEMBER SEEBACH: Stella.

MEMBER ADAMS: I just want to address Forrest for one second and then--as a community, I don't like the term activist groups, because we're advocates for our communities because we are on the ground seeing the harm that's being done in our neighborhoods. So if we're activists, it's to try to make progressive change in our communities.

I don't think that--the--nothing in the world would make me happier than to not be able to say "gotcha." I live for the day I can get a job working in a bank, making big money.

And that I don't--I don't feel the need to fight everyday for my community and for underserved communities and for underserved people in the marketplace. But "gotcha" isn't going to work. It's got to be an equal conversation between both parties to try to figure out how we can make the marketplace more efficient and make it work for all.

I want lenders to not look at lending to minority communities as some kind of legal obligation you have but as a business. This is a marketplace that you're missing out on.

Now most lenders that I know, the responsible lenders that are at this table, are not in the business of exploiting minority communities for profit, for excessive profit. But there are predatory lenders out there that do that. And that's also one of the reasons pricing data is so important is so that we as communities can move our members to--we want our members getting prime loans from prime borrowers. What we want is to ensure that people have access to the credit they have earned. If you have earned a paper, you should get a paper.

It should not be that Fannie Mae and Freddie Mac have done studies that show that 35 percent of the people in the subprime market could have gotten a prime loan, and they got to see all of the loan devalues; they evaluated the whole loan process.

And then when you look at that a upper-income African-American is twice as likely to have a subprime loan, than a low-income white applicant, that says that the marketplace is out of balance, the marketplace is not efficient, and its not working in the interest--it's good for the economy for all people to have access to credit and capital. It keeps the economy moving.

Why should our communities become desolate because we have--don't have access to good capital? And it's not just minority communities, I'm going to be Hubert Van Tol for a minute--it's also rural communities more and more. Who don't have access to prime lenders, and the only lenders in many a small town are like finance companies.

And so if you need a mortgage, that's the person, that's the access to capital you have, that's where you go. And so it's very important for those big box lenders who have finance companies, mortgage companies, A, B, and C paper companies, to make sure that if the only door I can walk in is that subprime company, because that's the only door in my neighborhood, that they have a product that's available that is equivalent to what I'd get if I were able to walk into your prime outlet.

And it's just one--and people really just want access to the credit they have earned. If you've earned subprime paper, and that's your credit risk, that's what you should pay for. And it's not a dispersion on the subprime market, but the goal of the subprime market is to rehabilitate people so they can get to the prime market. And what we're having is two markets being set up that are separate and unequal.

MEMBER SEEBACH: Don.

MEMBER CURRIE: I just want to get back to the issue of marketing. It seems to me sometimes there is an imbalance between--or maybe not an imbalance, but a kind of institutional, environmental fear on the part of primarily prime lenders, even the GSEs about using their marketing material and appearing to be, or being open to criticism as being too aggressive in their marketing or being open to charges of being a predatory lender.

I know in working with one of the GSEs, in using marketing material on loans that were already basically close to the foreclosure process in suggesting sending out material indicating need help with your loan, are you having problems paying, or are you in trouble, call this number and contact us and whatever happens to be the case, I mean they had major legal concerns about opening themselves up to, you know, aggressive marketing practices, charges of being too I guess institutionally -- appearing to be too aggressive with their product lines.

And I guess to look for a balance between the recognizing that a -- that a prime lender has a premier marketing channel as well and how to use that channel in such a way that one can get their message out about the availability of prime credit. They can get a clear message out about the availability of the difference between, you know, prime credit and subprime credit.

And being balanced enough and fair enough and free enough to be able to put that material out in the marketplace -- I think there's just a kind of a perception or a fear of basically doing that and opening themselves up to I don't want to say attacks but continuing questions on, you know, are they being too aggressive, and are they being too far out there in their marketing practices.

MEMBER SEEBACH: Lisa.

MEMBER SODEIKA: I was just going to add a little bit of a comment on this issue of negotiating a rate because it did come up in several of our discussions yesterday. I would agree that in most cases, consumers are not negotiating unless they're extremely savvy about the process. And savvy about where their credit stands.

Some of us actually lock in rate -- we say these are the credit risks for amateurs, and this is the rate, and it comes out of the system, and nobody can so much as make a manual error on a piece of paper. And not all lenders do that; there are some lenders who are still incenting folks based on profitability of the loans. I think those are the types of things that we should be looking at in terms of equalizing this marketplace.

Now there's a flipside to that, which was the conversation we had about the black box. You have to make sure that what those set parameters are, are appropriate and fair and not causing any disparate treatment, because once you push that button and say everybody fits in this box, it darn well better be an appropriate box. So, I think those are the types of ongoing discussions we need to have about what is that right balance and how do we make that fair pricing happen.

MEMBER SEEBACH: Governor?

GOVERNOR BERNANKE: I've been--a lot of the discussion has been about the importance of fair lending, of lending being race blind. Extremely important. Extremely important. It's important for communities, it's important for our economy and, I just want to--obviously I think we all agree on the importance of that.

The--I just want to tie us back, though, to the fact of the HMDA data itself which is particular institution and I think one thing that is important to mention is that I think we should all try to take a sophisticated view of this data. I mean, very simple-minded ways of looking at it, it's going to cause problems.

For example, one unintended consequence might be if we look simply at denial rates maybe that will just cause some lenders not to reach out into less favored communities because they'll feel if -- that they, you know, extend their reach they'll have a higher denial rate and that'll look bad on their data.

So I think in service of this very desirable goal of having open access and fair lending, which I fully, fully, fully support, we need to just keep in mind that, you know, we need to approach these data with the understanding that they are complex and we need to approach them with sufficient sophistication that we understand what they really mean.

MEMBER SEEBACH: Thank you. Marva.

MEMBER WILLIAMS: I agree with that. I think that the addition of the pricing data and HMDA reporting is a great opportunity.

I think that it can be empowering for consumers, I think it provides more information and ability to analyze mortgage markets for non-profits and community organizations, and I hope that it will also encourage banks to develop new products and new methods of outreach and marketing to lower-income and minority consumers.

One of the things I'd like to encourage the lending institutions to do is to actually reach out to community organizations in your assessment area and talk to them about what you've found in the data and what complexities you've found and what other mitigating factors you think are important. I'd say, you know, make that first contact, be proactive, don't wait for the community organizations, which are chomping at the bit, and we've already put in our request for data from several banks operating in the Chicago area.

Don't wait for them to come to you. Be proactive, go to them, and talk to them about your data findings and what you intend to do to mitigate or to solve some of those issues.

MEMBER SEEBACH: Thank you. Bruce?

MEMBER MORGAN: I'd just like to comment that one of the questions is what role could the Federal Reserve play? The Federal Reserve has some very good handbooks for consumers regarding adjustable rate mortgage, but I think those need to be updated and/or supplemented with additional data describing what a FICO score is. How does that play into getting a loan?

And I really view it as a collaborative effort between financial institutions, community affairs staff, with the district banks and community groups to really have some educational seminars and workshops. We sponsor first time homebuyer workshops. It's amazing how many folks won't show up.

In terms of the HMDA data, it's going to have some interesting points in it, I'll agree with Governor Bernanke, but let's don't generalize that all lenders are bad. When I owned a bank in Acheson, Kansas, I was the first bank ever to hire a person of color to work at a bank. And a lot of our customers were people of color, and they received prime rates. They were not pushed into subprime products.

Because the underwriting methods that we used, whether desktop underwriters, loan prospectors, they focus on the borrower’s ability to repay. And we had to have discussions what could you afford, what kind of payment could you afford. And we had to do a lot of consumer education, and we still do a lot of consumer education. Under the FACT Act, one of the disclosures that we give out now is what are the three credit bureau scores and what are the principle reasons you score them? That's a disclosure we hand out to every customer.

But rather than this become an adversarial deal and really set us back in terms of fair housing, I think what we should do is try to find ways of developing additional materials, additional outreach by the community affairs staff, and plan new efforts between community groups and lenders and the Federal Reserve educating people what are the implications of the HMDA data and what kinds of things can we do to stimulate growth and development of housing.

Frankly, I am a real estate lender. If I don't have customers applying for real estate loans, then I don't have a business. It is not in my best interest to make loans to people that I have to foreclose on because that means I failed as a lender. If I put a borrower in a loan that they can't afford and I have to take it back, I don't make any money selling the repossessed collateral. In fact, I generally lose money.

So it creates risk for me in the marketplace to have to go there and so we try to find products and services for people that are trying to acquire a home. One size doesn't fit all, as we discuss this. The lending landscape is a rich tapestry. We have mortgage brokers in our market that are abusing practices. When we find that, I think the Federal Reserve through their communication efforts can help get the word out that there are other alternatives other than to going to a full commission.

So as we have this discussion, let's all, I hope, work together to accomplish what the goal is, and that's to make more housing affordable for more people. I think you told us the other night, governor, that we're close to 70 percent home ownership in the country. And that's what our goal should be, is to get that number even higher.

MEMBER SEEBACH: Kurt.

MEMBER EGGERT: I think that consumer education is a good thing, but I think--I'm concerned that we're--that we don't get too reliant on consumer education as a solution to shark lending practices. And the reason for this is that the worst lenders -- I mean, there are great lenders out there that take good care of their customers, and we all know that, but there are lenders that don't.

And the worst lenders tend to target borrowers who are the least likely to benefit from the kind of consumer education policies that we're talking about. The worst lenders use telemarketing to seek out people who are not on the market, who are not likely to go to consumer education fairs, or to read brochures or to do the kinds of things we're talking about. They seek out--often they seek out the elderly, they seek out the financially unsophisticated, they look for people who are going to be somewhat impervious to the kind of consumer education we're talking about.

At the same time, we have lending products that are becoming more and more complex and difficult for consumers to understand. We're moving toward away from the old fixed rate mortgages that everybody understood to loans that rely on sort of this complex determination of whether you'll come out better if you have an adjustable rate mortgage for six or seven years and then adjustable afterwards. We have more prepayment penalties that require you to know whether you'll need to pre-pay to determine whether you're better or worse off.

We have fixed payment plans, interest only loans. The loan market is getting so complex that many borrowers, I think, have trouble understanding it. And so to say we'll rely on consumer--if we get too reliant on consumer education, we're dumping too much into their laps. Especially the least sophisticated borrowers who would have trouble understanding a lot of these products.

So I think consumer education is a great thing; I support it; but we also have to have as many systems in place to protect borrowers who end up in a room talking to a shark lender and get taken advantage of.

MEMBER DIXON: Thanks. I won't start with the last comment, but perhaps I'm going to come back to it.

I think that we all have expectations about what the HMDA data is likely to create in terms of dialogue going forward, and I think that there's probably not a lot of controversy about some of the loan biases, if you will, that may be in the market.

And I think the question is whether or not there is going to be an opportunity for some better analysis of the data and specifically back to Diane's earlier comment a question of how much of the differences in borrower loan pricing is a result of practices which should be discouraged if not prohibited, versus how much of the differences may be associated with legitimate differences in creditworthiness.

And then you, of course, get to the next question that Diane raised, how much of those differences in creditworthiness may be due to historical practices, which we would try to resolve.

And let me just raise one example. I think it's generally agreed that in the mortgage lending business, if you have a very small equity stake, the borrower is going to have a higher risk of default for a variety of reasons. And there are sub-groups of consumers for whom that is, in fact, their current situation. They don't have the net worth that other borrowers have, and so they, if they're going to get into home ownership, they're going to seek a loan that's a higher loan devalue.

So what can we do about that? I mean, as Bruce said earlier, lenders would--responsible lenders certainly want to make loans. That's the business we're in. But we have to balance risk against that. So how do we solve that problem? A number of solutions have been advanced, particularly in recent years with various forms of down payment assistance and in many cases that's supplemented with borrowers who are probably going to be operating closer to the edge of risk and risk of disruption, post-purchase counseling, credit counseling, and other forms of assistance to help deal with some of those facts, if you will.

And I think that frankly lenders have done some work to try and make their contribution to coming up with those solutions, but certainly there have been even Congressional initiatives and so on where, you know, appropriated money is found--the availability of that money goes up and down in cycles in this town. We may be in a down cycle at the moment based on some people's reading of the budget proposals and so on.

So, I think the lending community wants to address the fundamentals as well as some of the other issues, the education, of course, and so on--counseling and so on. But at the end of the day, there are groups of consumers who don't have the same creditworthiness based on our experience. And indeed we talked yesterday about some studies, one study in particular that was based in Pennsylvania of foreclosure experience and what are the causes of foreclosure and so on, and I think that there is still some analysis, but it's also true that not all the credit counseling is a perfect panacea on these and other studies, I think, are continuing to demonstrate high loan devalues are relatively more risky.

So to the extent that lenders are underwriting based on legitimate credit differences, then those -- some of those problems are still going to need further attention. And hopefully the HMDA data will allow us to effectively sort those requirements out.

Finally, as to the complexity of products that have been developed. Again, I think you know there's that half full, half empty view of a lot of these issues. You know, there is -- we are all encouraged to be creative. It was said today: let's find new products to serve the underserved. And we try to do that. Do some of those new products present new opportunities for abuse? No question about it.

And is there a perfect mix of product creativity versus consumer protection? I'm not sure that there is a perfect answer that works well for every consumer in every market, so if we're going to continue to try and be creative in the lending and finding effective products, then it's going to have to be a continuing dialogue on how to make sure those products are offered responsibly.

MEMBER SEEBACH: Thanks, Dan. Mark.

CHAIR PINSKY: Oh, thanks Mary Jane. The -- there are a whole--there are sort of two layers of this issue it seems to me as I listened to the conversation yesterday and I listen to it today. There's the reality issue, which is -- you know, as Dan talked about and as others have talked about, which is what's really going on behind some of the discrepancies we think we're going to see.

And then how do you deal with them and how do you deal with them on a one-on-one basis. And there's another layer that concerns me, and it concerns me more and more as I think about it, and Governor Bernanke, it goes a little bit to your comment, which is these are sophisticated data, and they're complex data, and they're in some ways incomplete data, right? I mean, we can only answer so many questions, and, you know, it's my assumption that there are--you know--on the one hand there are folks around this room who want to find a reasonable and rational solution that's going to make markets work for everybody equally.

But there are other folks who aren't going to want to do that, right, who do want to say gotcha. I mean, that's what they're waiting on these data for, and I also think that perhaps more relevant in the short term is I think that there are probably a lot of folks in the media, some number of folks, in the media who see a Pulitzer Prize down the road if they can figure out how to report on these data in some way.

And I think that there's a public perception problem instead of a public relations problem around this that could complicate this and as Forrest said, could create more disagreement rather than getting people to work together and so I would just suggest from the Federal Reserve perspective that the twelve banks, the community affairs officers through their banks could play a really critical role in trying in an ongoing way to try and bring community groups and lenders together to really dig into the data to really sort of work together on this. Because it is complicated, and it’s going to be hard to understand and people are going to jump to conclusions or make assumptions and some of those we right and some of those we wrong.

But I think that that's a system that’s--you know, that the CAOs are a system that could be really effective in keeping this through whatever, you know, excitement happens as a result of this and really keeping this focused on what are the important issues, those things that we need to work through and it's going to take us years to work through, I think.

GOVERNOR GRAMLICH: Mark triggered another thought, which is that we are--some of us are going to be making speeches about these data and in line with the sort of the sober evaluative mode here, how can we--what do these data mean, how can we--if there are practices that ought to be improved, how can we improve them and so forth.

If there are helpful things for us to say about the data, I would certainly welcome any contributions. You can all--you don't have to do it today, you can all e-mail me as time goes on, but I am certainly open to suggestions for points that might be made about the data. Just put that offer on the table.

MEMBER SEEBACH: I actually--I am very pleased to see in the Chairman's comments recently and again in Glenn Canner's comments a lot of useful discussion, point/counterpoint on the data, and I think to the extent that the governor's and the Reserve Banks continue that sort of point/counterpoint discussion and, as Mark says, bring together lenders and advocates, it's going to be a very useful discussion.

DIRECTOR BRAUNSTEIN: Mary Jane, I just wanted to add something to that from what Mark said is that we do have an internal group here that has been working for some time in talking about what we can do as the Federal Reserve to address the upcoming HMDA data, and part of what we are talking about is doing a pretty massive outreach effort through the Reserve Banks and the community affairs officers, so, you know, I think we will be out there and we hear what you're saying about that.

MEMBER SEEBACH: I will just note, though, that I think that has suddenly taken the form of--I got a panicked phone call yesterday, the San Francisco Fed needed to know now what my response was going to be to the release of the data, and I thought that's not particularly helpful. So I ask generally that, you know, we certainly look for a dialogue and we certainly look for any help we can get, but it's that sort of--if I could in a moment gel all of the analysis and the thoughts that we're putting into truly understanding our own data before we engage in conversations into a three point brief, I'd do it.

But--so I encourage you to give them a heads up that that's not the way we're going to--most lenders are going to handle this. Let me do Anne and then Hattie.

MEMBER DIEDRICK: I just want to circle back something that Stella said and also Stella we appreciate your tremendous knowledge on this topic and the things you had to say.

The thing I do want to say, though, is be really careful about equating high income with good credit. It's like saying low income as bad credit when you go high-income and good credit. When you look at subprime lenders, you're going to see a lot of people who make a lot of money who have really terrible credit, and we have very, very low-income borrowers who have excellent credit and are terrific customers so you want to be very careful of ever equating high income/good credit. It is not a correlation.

MEMBER ADAMS: Didn't mean to do that, but I don't think--I also think that saying high-income blacks have worse credit than--I want to make sure that we don’t equate race with creditworthiness, as well. And I believe strongly--I'm a fair housing, fair lending advocate, that you get the credit you have earned.

If you are a low-income borrower and you have earned A+ credit, you deserve access to A+ products. But they really don't exist a lot in those low-income neighborhoods, so you have to have outlets such as where there are A products through big box channels that have channels in those communities to get that, otherwise that A+, low-income borrower by virtue of geography is locked out of an A+ product. And so I really want people to have the credit they have earned, regardless of income, regardless of race, and regardless of gender, but that you get the credit you have earned.

If you have worked hard, followed the rules, and meet the qualifications because of geography or gender or race, you should not be denied that that you have earned. That's the meritocracy that is America. And that's how efficient marketplaces work.

MEMBER SEEBACH: Hattie gets the last word.

MEMBER DORSEY: Oh, my goodness.

Just wanted to respond a little bit to what Mark just said. Coming from the city that put out "The Color of Money," I would guarantee you that community groups are waiting for the HMDA data and that as a part of that grouping that I will be asking for, especially some of the banks that are now trying to make some aggressive moves into neighborhoods that they haven't gotten into before, on the release of "The Color of Money."

My concern, however, as we review the data, will be around the pricing and whether or not various communities will recognize and see whether or not the pricing differential is there.

And so what we're going to be looking at is that in particular, but also whether or not they're continuing to lend or will they be willing to lend in some still outlying communities around the central city that has not seen any revitalization?

I would say that the HMDA data and the release back in the '90s did get some attention to very depressed neighborhoods that began the revitalization process, so we use it as a tool and maybe a little bit of a hammer.

MEMBER SEEBACH: Thank you. That's it.

CHAIR PINSKY: Thank you, Mary Jane. Thank you to the Community Affairs and Housing and the Compliance Community Reinvestment Committees for a great job on that.

I really get the last word, Hattie. But, no, I think that's right. I hope everybody will use it as a tool. I think, as Governor Bernanke said, it's a complicated tool, and I think that everybody should use it, you know, people are going to use it to make the points that they see, and I think that's a good thing. I think--my hope is that the conversation on this throughout the country will be as calm and rational as it is in this room, but somehow I don't think that's always going to be true.

But I do think this is an issue we knew at some point last year we knew that this was--that the HMDA data was an issue we were going to be talking about not just at this meeting but throughout the year and so we will be revisiting this. Imagine the conversation we have when we actually have data.

Thank you. The Depository and Delivery Systems Committee had a lively discussion yesterday on Reg E, Electronic Funds Transfer Act, and Forrest Stanley, the chair of the committee, is going to lead us through that conversation.

MEMBER STANLEY: Thank you. Just to kind of set the stage, the Board issued a proposed rulemaking in September of last year and the comment period closed in November of last year.

The Board assembled for the committee; the comments kind of summarized them and asked the committee before the rule went final for final comments generally, but they also asked us to focus on three principle areas.

One, payroll cards; two, electronic check conversion; and three, oral authorization of recurring debits.

What I'd like to do is kind of segment the discussion, if we can, and put payroll cards first. Payroll cards in the--is a new and innovative product. I think to the extent we have consensus in our group, I think everybody agrees it's a good product. It does help the unbanked considerably. It's quite honestly targeted at the unbanked. And under the proposal, payroll cards will be given full Reg E protections, and payroll cards are defined as directly or indirectly established by an employer.

The issues that we did have in the community that we discussed were the extent of the--some of the disclosures. The effect or the unintended consequences of not just the rule but how the product is triggering compliance concerns in other areas and whether or not you need a full Reg E periodic statement for this product.

I will also just say as a note that the person who created the nameplates has to be under age 30 and never wore glasses. I've asked my seeing-eye banker here to help me identify people because I have no hope of reading these nameplates.

(LAUGHTER)

So with that and--you know--I'll ask Dennis to go first, and then we'll just start the discussion.

MEMBER ALGIERE: Thanks, Forrest. Just two comments on the proposal. Certainly can understand the reasoning behind the proposal, in the proposal enabling the consumer to be able to track his or her payroll card balances and also understanding the reasoning behind giving the consumer a means by which he or she can get an idea if there is any unauthorized transfers or unauthorized activity going on in that payroll card.

But the operational issue I have, I would like to raise, is a bank sending out a statement or any type of correspondence to that consumer. In many cases, these holders of the payroll cards are not customers of the bank. In order for the bank to send out a periodic statement or correspondence they would need correct addresses, and the bank simply does not have that information. They would rely upon the employer for that information and that data can change daily.

It would be an operational issue a bank would have to confront if, indeed, they were to have to send out a periodic statement.

Secondly, is a more--it's an issue along the line of unintended consequences and that's the definition of account holder. If we're going to include this holder of the payroll card in the definition of account holder, there could very well be issues with other regulations, compliance with other regulations, such as Gramm-Leach-Bliley, a number of AML, BSA, USA Patriot Act issues, 326, 314 A.

And also FACT Act, KYC--banks simply do not know who that holder is. We do not have the relationship in some cases with that holder because they're not a customer of the bank. And certainly these days, with AML and USA Patriot Act being high on the list of compliance with regulatory bodies, that is a concern that I have. Other FinCEN related regulations, deposit insurance, and I did mention Gramm-Leach-Bliley--whether or not we'd have to send out disclosures, such as privacy disclosures, to these consumers.

Again, I preface my remarks with the fact that I do appreciate the consumer being able to track their balances and understanding whether or not they have any unauthorized transfers, but it could open up a can of worms, and we need to maybe look at this outside of the arena of Reg E and maybe look at other regulations. Thank you, Forrest.

MEMBER EGGERT: I think payroll cards, I mean it's a very interesting innovation, and one of the things that we're always looking for, I think, in a way--and this ties back to the last conversation we had--is to increase the financial literacy of people to the extent we can. And if you have something like payroll cards that's designed for the unbanked, one of the things we want to--should want to look at is how can we change the unbanked, to the extent we can, into the banked--to increase their financial literacy, to let them use banking systems where they are appropriate for them.

And so when we look at how we treat payroll cards, I think one of the things we should look at is how can--if we give people a periodic statement, they get more comfortable with the idea of oh, I have this account and I can look at this account and I can use this account in intelligible ways. And so I think the statement has an importance even beyond its use by the individual employee.

As to the--I acknowledge that there's a cost in doing this. Obviously statements are not free to mail. And addresses do change. However, I think you can make too much of the idea that addresses change on a daily basis, because all you have to do is mail out the statement periodically. And so as long as the employer periodically notifies the issuing company here's the address right now and you send out the statement, it doesn't matter if their address changes in a week because I mean, that's what happens to all of us if we move.

So I think it's important for us to look at this sort of systematically how we view it in the larger context and so things like statements are important.

MEMBER ANDERSON: I'd like to address, first, the--what Kurt had said about do we want customers or members to go to an interest-bearing, dividend-bearing account so in that way I know the convenience of payroll cards, but if there is a way that we can inform these customers that you'd want to switch over and have your money make money for you, that would be great.

As to the address issue, it's not that easy from a financial institution's point of view. I know that we have members at our credit union where they're our members, but we don’t have a good address for them, and we have their money, and it's still hard to try to give them their statement and--I mean, that is a big issue with financial institutions because now with the fraud we always want to make sure that we don't just change addresses, you know, based on a post office label, but that we're able to confirm the address.

And as to the third issue regarding issuing a periodic statement, while I can see why and we would support why customers would like to see where all their money is going, it would prohibit the smaller financial institutions, like credit unions, from offering the service of payroll cards, because it would be too cost prohibitive.

MEMBER DIEDRICK: Well, we also agreed that payroll cards should be covered by Reg E; we also agree with everything Dennis said, and the consumer will have access to information online or by the phone so I sort of wouldn't want to have to do the periodic statement.

MEMBER HICKOK: I would echo what Faith just said, it isn't as simple as generating an account statement.

The financial institutions core systems would require them to set these consumers up as account holders in order to generate that periodic statement, which does play into what Dennis said in terms of them becoming an account holder, so operationally it just isn't that simple.

MEMBER CARTER: There seems to be fairly widespread agreement that extending coverage of Reg E to payroll cards is a good idea, assuming that some details can be worked out.

I'd like to urge the Board to go beyond extending it to payroll cards, and to extend it to other similar recurring payments such as child support, unemployment compensation, other income--recurring income substitutes that are like wages.

MEMBER STANLEY: Clint.

MEMBER WALKER: Thanks. I'd kind of like to just echo what Dennis said; the big concern that I would have--I agree with putting payroll cards under Reg E--we'd examined every year clients under, say, the Patriot Act, AML, things like that. The fact is, you don't lose a customer because it's--the employer wants to generate the--it's going to be very, very difficult to comply with those regulations. I don't see how it's done. I would just really urge the Board to really look at some of the impact of some of this proposal on banks and clients with other regulations.

MEMBER THOMPSON: I would want to echo Kurt's concerns and maybe amplify them a little bit. If one of the reasons that many lending institutions talked about for the creation of payroll cards was to provide services to the unbanked and to move the unbanked to the banked, so from a consumer educational standpoint it's very important to give people meaningful access.

The other reason that we've talked about, the importance of Reg E protections for payroll cards is this is for most of the people who get payroll cards, most of their money. And they need to have meaningful access to information about that and meaningful control over it.

Access by telephone for a low-income worker is not meaningful access. Many, many low-income workers do not have a private telephone line. Probably a third of our clients do not have a private telephone line. You also have a problem if you're going to give it through an ATM; there are not ATMs in the same quantities in low-income neighborhoods as there are in other places; it's not a secure and private place to retrieve your account information, nor is it a good place to get it in a way where you can keep that information, you can review it, you can check to see if there are any errors.

Similarly, getting it online doesn't work; most of the low-income people I know who have access to computers or access to online do that at the library. Myself, I don't want to have my--the only place where I can review where all of my money is is at the library. That's not a place where I've got privacy and where I've got control over it.

I think some of the other concerns about compliance and compliance with other regulations are well taken; I think that those can and probably should be addressed. Concerns about addresses changing--addresses are going to change any time we deal with people who are low-income and in, perhaps, unstable jobs. That's not a reason for refusing to give them information that they need in order to access and control their money.

I think if we want people to exercise any control and have any meaningful control, we have to give them statements in a form that they can keep. And if we don’t do that, then we have real problems with what their rights are if there is a dispute. How are we going to let low-income workers who get their money on payroll cards find out that there is a problem and find out that there is an error and what kind of dispute resolution mechanisms are we going to give them if we've never given them a paper statement that tells them how much money is in the account? That's something very basic that all of us expect before we move forward.

In our discussion questions on this point there's also the question about whether or not there should be coverage in the case of a payroll card that's optional versus one that's mandated by the employer. And while certainly the arguments, I think, are less strong under those circumstances, you would want the coverage to be extended to cases where it was an optional choice as well for the reasons of extending coverage to the unbanked and also to promote uniformity.

So if somebody had a payroll card where it was mandated by the employer and then they moved to another place, they weren't suddenly confused and lost all of their protections because they chose the payroll card.

MEMBER ADAMS: I hope you all can figure out a solution to this problem, but I don't want you to forget the importance of payroll cards to the unbanked.

In some of my communities it's a matter of life and death about where their money--how they have access to money. A lot of folks in our community who were cashing their payroll check and taking it home were subject to home invasions and robberies because people knew that the folks in that community were cash and carry people and cash and carry costs lives.

And so the payroll card became a way to have their money in a secure fashion that would not--that they could protect--it is a matter of protection. So if the--I was thinking why can't an ATM--it records my debit transactions and tells me what my balance is, why can't it do the same thing on the payroll card and maybe at other points of purchase or whatever as we get more sophisticated with that kind of technology, be able to print it out there as opposed to trying to mail it?

But hearing Diane, I don't know that that will work. But, I don't want banks to say, well, because of all of the costs associated I don't want you eaten up because then you're no better than the check casher and we lose the benefit to the low-income borrower if we put too much cost in the delivery. But at the same time, I don't want us to lose sight of the very real--some people really need these payroll cards as a matter of self-protection before--and there is a way to move people into the banking system, but otherwise a lot of these people would be out of the system, and they'd be victimized.

MEMBER STANLEY: Just one point, and we'll go to Benjamin. I do think most ATMs can give histories and balances. I mean, that's currently actually kind of a required disclosure. How much detail they give does vary by the ATMs. I wouldn't suggest, though, to Diane's point, that the information you get on the ATM is as complete as a periodic statement.

Benjamin and then I would just like to--I know we have some other people, but I would like to just raise one of the other issues. We can still discuss this issue, but there is the one other issue I wanted to just throw on the table. But Benjamin and then I'll --

MEMBER ROBINSON: Yes, sir, I'll be brief. I couldn't imagine the last ten years of the card industry would have changed so drastically that we're actually having a conversation about payroll being deposited on cards. Withstanding Stella's comments, I do think the overall issue is, you know, is the use of payroll cards a real solution to access of money for the communities that need that access?

The one comment I would say is that the compliance and regulations need to be appropriate and proportionate to the technology. And this is one case where personally I'm not sure that having payroll on a card that is not very secure in terms of technology is really the way to go. The choice we have to make is do we offer an interim solution that we're prepared to deal with the challenges, or do we fight and continue to strive for the overall solution?

MEMBER STANLEY: I would just like to raise what kind of is a second issue and then not to constrain anybody's comments necessarily that there was the electronic check conversion was one of the other topics we discussed and talked about something that is confusing both to consumers and people in the industry although we have some excellent people on the committee that understand it far better than I do.

But under Reg E there are new disclosures that would be required for want of a better term at point of sale and there were various alternate disclosures and the efficacy of those disclosures, whether or not there could be a sunset provision, whether or not there still needed to be a signature because there is a signature required I believe. That was an issue we also discussed. And Michael, I know you're on next--you don't have to -- don't need to limit it to just that issue, but I just wanted to tee that issue up.

MEMBER COOK: I appreciate that, Forrest. Let me just mention one thing regarding payroll cards. I do believe that if the burden is so great of the cost of what's required is part of payroll cards that it will restrict the development in the industry, I think the Board should consider the fact that it may be beneficial to allow the other methods of delivery of information to the employee, whether it be at the point of employment, if statements are available to the individual there.

Even as far--I guess the view would be that at a minimum, or at the very far reaching of the requirement is even if it was conceded to that maybe that the employee would have the choice. To force the issue that the employee wouldn't even have the choice, they're going to get a mailed statement, one way or the other. It seems burdensome on both the employer, the program itself, and should be remembered that when burdens like that are placed on the program, those additional costs eventually are passed on to that individual in some other fees or some other costs associated with it or the program never moves forward.

And the progress of those initiatives never moves forward. On the second issue regarding the proposed language on electronic check conversion at the point of sale, our position would be is that the proposed language that is in the documentation that we have, I believe is somewhat inaccurate. In statements that--where particularly says that your funds may be withdrawn from your account quickly or, slash, as soon as some--as the same day we receive your payment. And I believe that pointing that out is inaccurate and that it's misleading to the consumer and is unnecessary.

The second piece of that also goes on to restate that you--that the statement or the notice would state that you will not be receiving your check back from your financial institution. I think that's a given in the fact that most merchants in that case actually give the check back to the consumer, so it's of little benefit to reiterate it in the notice that you're not going to get your check back in your statement. So the proposed language, if you only look at the first sentence of the proposal, would seem to satisfy the requirement associated with what would--the consumer would need to know in that case.

MEMBER SPRINGMAN: Yes, I guess we talked yesterday about a lot of issues around you know electronics and the type of transactions consumers perform. Market factors are making the transactions just buying goods and services more complex. You can pay with a check, you can get your check cleared, you can do the electronic conversion of your check. Credit card, debit card, it could be pin; it could be with a signature.

I think we have to step back and just look at that transaction and how is that person who is executing it on the merchant's side being able to sort out all the rules--how is the consumer really going to understand and as we look at each one in isolation like the electronic conversion of checks you say yeah, well, that's logical to disclose this at the point of sale but when you bundle everything potentially into one spot I think we're going to confuse the consumer as much as we're going to help the consumer.

MEMBER STANLEY: Dennis.

MEMBER ALGIERE: Just getting back to the payroll card--and I'll put aside cost a minute and we won't even--I won't even raise the issue of cost. What I was trying to point out is just the practical operational issue. The bank in most cases will be dealing with someone who is not a customer of the bank. We often have times delivering mail to customers because they move.

And just practically speaking I think that it's important, and I totally agree with you, Diane, that that individual has a right to know what they have in their account, and clearly has a right to privacy in their own home to look at something in a statement. And certainly has a right to determine whether or not anyone is using the card unauthorized. But just from an operational point of view, practically speaking, it could be difficult for banks to provide statements to someone who is not a customer of the bank.

MEMBER HICKOK: I'd like to echo what Mike said about simplifying disclosure and trying not to put too much information on the consumer in terms of how that check would be processed.

Give you an example of the kind of confusion that exists with electronic check conversion. Let's take a medical office, for instance. A person that is in the medical office receiving treatment that writes a check for a co-pay, if in following the NACHA rules that check would be voided and handed back to them and they would sign an authorization consenting to that transaction, that same person would be able to mail a check in for a payment on an account with that medical office, and they won't receive the check back because its converted into an ARC transaction which the disclosures only require.

The same medical office cannot take a check from an insurance company and convert that electronically because it’s ineligible to work ACH conversion, but it could be processed through Check 21, so with electronic check conversion, we have a lot of confusion on the part of the businesses that are trying to make things more efficient, and we have--definitely we'll have confusion on the part of the consumer. I think that the consumers' financial institution is in the best position to educate the consumer on the different ways that their check, if it's presented to a merchant, or to a business, may be processed.

MEMBER STANLEY: Carolyn.

MEMBER CARTER: I'd like to follow up on what Deb said and Paul. One the Board has tried to draft notices to the consumer that explain what happens when the consumer presents a check or makes a purchase and there's some difficulties in doing that and I think those reflect the fundamental irrationality of the distinctions in the law between what, for the consumer, are indistinguishable transactions or have only slight differences that seem to be very insignificant details.

For example, the period of time to request--to dispute a charge could be forty days or sixty days depending on differences that the consumer would probably never notice and wouldn't attribute any significance to if the consumer did notice them. And all of that is not the Board's fault, but--because I think a lot of that is--a lot of that is embedded in laws that the Board does not have the power to change, but I would urge the Board to in the long run try to solve this problem by making the distinctions more rational, making the system, the rules, more uniform and moving Congress toward making the EFTA rules the standard for all the different types of transactions that look like to the consumer and to the merchant and to the bank that look like electronic fund transfers.

I'd also like to address another one of the issues that Forrest mentioned, I think it’s the last issue on our list, which is written authorization for recurring debits. In the Board's proposal, in the commentary to Reg E right now, there is a statement that a tape recording of oral authorization for recurring debits to a bank account isn't--doesn't meet the written authorization requirement of EFTA.

And the Board's proposal, one aspect of the Board's proposal is to delete that comment from the commentary because some members of the industry have raised questions whether that violates the E-Sign Act. First, I think it doesn't violate the E-Sign Act because the E-Sign Act says that an oral communication or a recording of an oral communication shall not qualify as an electronic record for purposes of the consumer consent provisions of E-Sign.

The consumer consent provisions apply whenever information is given to a consumer and of course when the consumer signs, when the consumer agrees to an electronic--a recurring electronic debit, that's not necessarily giving information to the consumer, but part of that requirement of EFTA is also for a copy of the authorization to be given to the consumer.

So that is giving information to the consumer so the consumer consent provisions apply and an oral--and then E-Sign makes it clear that a tape recording of an oral authorization is not sufficient to meet the requirement of a writing.

Now why is that important? That's important because of telemarketing. When the FTC adopted its do not call rule, it also made a bunch of other changes in its telemarketing rule, and a lot of those were based--it had extensive enforcement history of complaints involving exactly this sort of thing, where a telemarketer would get someone on the phone and the person would say "uh-huh," try to get the telemarketer off the phone and would unwittingly give consent to transactions that the consumer never believed that he or she was actually agreeing to.

So I urge the Board, both for legal reasons and for public policy reasons, to keep that part of the commentary exactly the way it is.

CHAIR PINSKY: Forrest, we're supposed to be ending up. But why don't we take five more minutes so we can have a chance to cover the--

MEMBER STANLEY: Okay, I was going to ask--Kurt.

MEMBER EGGERT: Thank you. I think whenever we move in this field we should sort of keep track of the original purposes and why we use checks to begin with. I mean, checks are a negotiable instrument in the payment stream, and they have kind of three essential purposes.

One is to move money along in the payment stream. One is to document the original--the intent of the originator so we can say what the heck the person meant when they signed the check. And the third is to prove ownership of the payment so that the originator doesn't have two people who are claiming that they should be paid.

Now we're--as we move along, we're doing great on moving money down the payment stream. We're doing fine on that. But my concern is that we're not doing so well on documenting the intent of the originator. As we move away from paper checks to a completely electronic form of check conversion with the original check destroyed, what chance does the originator have to prove what they intended to begin with?

Or what chance do they have of arguing that, oh, the person at the--entered the wrong keys? Now, currently, the system we have is if you--the check is voided and handed back to you, that's good evidence of what you intended. But if we move to a system where you can hand somebody a check, they take it, they keep it, and then later they keystroke it in, and they destroy the check, then where does that leave the check writer?

So I think we have to keep track of these original three purposes and make sure that we stay on all three of them.

MEMBER STANLEY: Okay, we have one minute--Michael, if you'll take thirty seconds and allocate thirty seconds to Deborah, we'll wrap this up.

MEMBER COOK: I'll just make one other point. If I'm not mistaken, the Treasury Department already converts business checks and what is considered ineligible items for the rest of the industry in addition that they do not follow the requirements that NACHA has regarding notification, as well.

I feel it's difficult to understand how industry or commerce can be held to a different standard in this case, and I would just suggest that we look at the model that is in place today with the Treasury and look at problems that have occurred with it, which I do not believe that there are any, and open that duplication of that same process to commerce in general.

MEMBER STANLEY: Deborah, you get the last word.

MEMBER HICKOK: Also, not to be overlooked is that with ARC transactions and Check 21 in order to protect the initial intent of the consumer, the imaging technology is there now. The only transaction the electronic check conversion that doesn't require an image, coincidentally, is the point of purchase transaction where you are giving the check back to the consumer who you have to trust will keep that record and be able to have it.

If we were imaging all of the transactions that were being converted, we would have that original intent on the original document, and so again inconsistencies on image requirements in some transactions and not in others.

MEMBER STANLEY: Thank you.

CHAIR PINSKY: Thank you. Lori Swanson, our Vice Chair, wanted to comment on this.

MEMBER SEEBACH: Oh, I'm sorry.

MEMBER SWANSON: Just going to real quickly mention I'm glad Carolyn raised the Federal Trade Commission. As I look at telemarketing fraud, it has created a verifiable period of full employment for a number of assistant attorney generals throughout the country as well as the Federal Trade Commission.

It is a--telemarketing fraud and recurring transactions is a huge problem. It occurs all the time. Actually, particularly with recurring transactions, because of how small the charges are, and how they recur over a period of months and people don't catch it, so I would just strongly encourage the Board to look at the comments of the Federal Trade Commission as it relates to these recurring type of charges and to keep the existing law in place, which prohibits recurring charges without the written authorization of the consumer. I think the written authorization of the consumer provides the clearest evidence of consent, and is good not only for consumers but as well as for the consumer's banks, which otherwise are going to have to deal with all these phone calls that occur from people disputing charges, so--thank you.

CHAIR PINSKY: Forrest, thank you. Thank you to the Depository Delivery Systems Committee, that was terrific.

I think we'll take a--I think we can still take a 15-minute break, so I'm going by the clocks on the wall here. We'll come back at five after. When we come back, we're going to talk about the Community Reinvestment Act, so don't be late.

We're going to talk about Truth in Lending, and then we'll have Bruce's presentation. We'll make up this time, Bruce, not out of your presentation, but out of the committee reports at the end, so, I don't want to cheat you out of your time. Great, thank you.

(Whereupon, the foregoing matter went off the record at 10:50 a.m. and went back on the record at 11:07 a.m.)

CHAIR PINSKY: We have an hour dedicated in our conversation to the Community Reinvestment Act, and I have a feeling we'll be able to fill that time productively and the Compliance in Community Reinvestment Committee had a very good discussion yesterday and Anne Diedrick, our chair, is going to lead us through our conversation.

MEMBER DIEDRICK: Thank you, Mark. Last Friday the Board joined with the SEC and the FDIC in jointly issuing a notice of the proposed rulemaking to revise provisions of the Community Reinvestment Act.

Specifically, the proposal would address regulatory burden imposed on some smaller banks by revising the eligibility requirement for their CRA evaluations by creating a new category called intermediate banks. These would be banks with assets between $250 million and $1 billion.

The proposal would simplify the lending test, and it would propose a new community development test for these intermediate banks, and it would expand the definition of community development to include affordable housing and other activities in underserved rural areas and designated disaster areas.

I've decided to break our conversation into two segments. The first segment, we are going to talk about how to encourage more community development activities in rural communities. Also, we're going to talk about this expansion of the definition to include underserved rural areas and also designated disaster areas.

And after that, we'll have a conversation about the proposed community development test. So, would somebody like to lead off in talking about ideas that you might have for expanding or encouraging the opportunities for banks to provide community development loans, investments, and services in rural communities?

MEMBER WILLIAMS: Well, one of the factors that I was very interested in from the staff memo that we received, is the high volume of lending that intermediate, small banks provide to--

CHAIR PINSKY: Marva, can you pull the mic a little closer to you? Thank you.

MEMBER WILLIAMS: One of the factors that I was very interested in from the staff memo that we received was the fact that a very high proportion of lending to small farms comes from intermediate, small banks. And so I hope that as part of the enforcement of this proposal if it does become a final rule that there is continued emphasis on lending to farmers.

The cliché is the devil is in the details, and I think that the enforcement of these new provisions are very important and also to consider looking at how farmers and people in rural communities will be impacted by these new regs.

To speak to the rural issue, in our market, we find that there are a large percentage of low- and moderate-income people living in our rural communities and a large percentage of minority folks living in rural communities. And yet the census data for those communities, I think, is skewed, because there is a small percentage of people that are higher-income that live there.

And so the challenge has been that we can't count a lot of activities because it's not a low- to moderate-income track. And there is difficulty in proving that we're serving, specifically, low- to moderate-income people. So I think the options that are laid out in the proposal for other ways of defining rural are good, and I don't have a recommendation about what the answer is, except to say I don't think that using the CDFI fund definition is a good idea, because it's very complex, and I don't think that it'll be easy to uniformly apply across the country.

We have challenges with the USDA definition of rural and so I wouldn't recommend using that one either and I don't know about raising the median income level, but I do think that it's going to benefit rural communities generally across the country to expand this availability of CRA credit, if you will, to activities and services in those markets.

And I think these are--there are limited opportunities and so the extent you are incenting financial institutions to do more there, that's going to be a good thing for these communities overall.

MEMBER DIEDRICK: Stella.

MEMBER ADAMS: I think it's important when we talk about rural to look for a broader definition than the one that currently is used. Because if you are in a rural poor county and 80 percent of poor is just poor, and so we--the median income that is currently used doesn't take into account the difference in--if you're in a poor, rural community what that means.

So maybe looking at statewide median income may be a better measure to look at, but--we also, I think, need to consider looking at, consider distressed communities, economically distressed communities where you have large outflows of jobs. In North Carolina, for example, we've had counties that have been devastated because the only real industry was either textiles or manufacturing of furniture and those jobs are now not in America anymore.

And we've had hundreds of thousands of people out of work. This may not be a rural community as previously defined, but it's certainly a distressed economic community that banks should get some support for coming in and trying to work on the--in those--areas. Another kind of distressed economic community is where you have had, like we saw in our community and housing meeting yesterday, the study in Philadelphia, where you have just counties that are devastated by predatory lending.

If--and lenders who go in and try to stabilize those communities and get those back into healthy housing markets, they ought to be able to get benefits from that, so whatever--when--we should also consider not just disaster areas, but also economic disaster areas that are kind of distressed communities, because of conditions that may not be reflective in the income of those communities but certainly will destabilize them in the future.

MEMBER DIEDRICK: What about communities that were middle-income communities and then had a natural disaster or an act of terrorism? Does anybody have any--

MEMBER WALSH: Yeah, we--our experience is and this is pointed out in our meeting yesterday--our experience is that when you have a rural community even if it's upper-income or a so-called resort area, the natural disaster like a hurricane will result in a significant loss of jobs. Temporarily, sometimes longer term and possibly a loss of housing and possibly a loss of small business.

We experienced this with our hurricane in 1992 and that particular county has barely recovered in thirteen years, so it's--I think even if it's middle- or upper-income, the lower-income residents or workers in that community are going to be affected and so to count activities that help to restabilize those areas are going to be really important.

MEMBER DIEDRICK: Mark.

CHAIR PINSKY: Yeah, I mean I think the challenge often with the Community Reinvestment Act is the "it depends" problem. I mean, you know, this is one of those "it depends." I mean, listening, Kelly, to you talk about that -- we've done a study of the--of bank response to 9/11 in lower Manhattan and there were banks that were very--sort of get involved and then--and a lot of banks that did, you know, a tremendous amount of good, often in partnership with CDFIs but they were just--they were eager to do things and to help.

But it would be hard to say that shouldn't qualify, and then on the other side you find out if you read the papers that a lot of the emergency assistance went to help--I won't name big companies--but big Wall Street firms and, you know, you get into that issue of what's the right thing? I mean it certainly, I mean, it certainly may have helped keep jobs there, maybe it helped keep people who lived in New York in their jobs there and not have to commute as some people did to Princeton or you know--and another low-income place, Princeton.

So I think that's true. But it also comes up, I think, Kelly, in your comment about the CDFI Fund, you know, the proposal that they--would the CDFI Fund definition of rural matter or be useful. And I agree, it's complex, and it may not be the right thing in a regulation like this. But some of the things that they were trying to capture were things that were particularly relevant to the upper midwest and to the Great Plains that when you took those things out of there I know from the CDFI Fund, you suddenly had in South Dakota and Minnesota you suddenly had, you know, you couldn't do CDFI activity there because you didn't qualify.

And if you included things like out migration in, then you could. And so there are a lot of different markets and I think, you know, what's challenging about this is that most of who is covered in this proposal in the intermediate-sized banks are those small banks or, you know, or just proportionately as I understand it are rural banks. I mean, they’re more likely to be rural banks.

And you know it's hard. What I think is good about this proposal and I have questions about this--some things about this proposal, what I think is good about it is the sort of the spirit of innovation about it--is we recognize there's something going on in between and we need to create a place where you can do innovation. The challenge is how do you make sure that you're really, if it's a natural disaster, how do you make sure that you're not refinancing a mansion, a millionaire's property or something and does that qualify.

MEMBER MORGAN: I think I am the only financial institution on the Council that's less than $1 billion in total assets. I favor this change in the ruling, and I want to compliment the Board for getting together with the other banking agencies so that we have consistent rulemaking between FDIC, OCC, and the Fed. I know OTS has kind of gone out on their own, and the last thing that we need in small banks is to be shopping for charters and changes of charters because of disparity and predatory impact.

But I would say, also, that this proposed change does not mean that small banks will not continually be examined. We will be examined under the CRA, it'll be a streamlined exam, and as someone said earlier, the devil is in the details. And I would like the focus of the Board in working with their supervision folks in trying to implement this rule to start giving small banks and community banks credit for the community development and economic development activities that they actually engage in in their local communities, whether rural, whether suburban, whether urban.

Right now, the CRA process for us on the ground has become a statistical analysis. Your assessment area, how many loans are in, how many loans are out, what are the demographics of your loans, what are the demographics of the area. No recognition at all for the things that we do day in and day out contributing to the development and retention of businesses in northeast Johnson County, the development of new businesses, support to rehab the Shawnee Indian Mission. I mean, I could list twenty-five projects that we've been involved in in the last twelve to eighteen months that we get zero recognition for in the CRA exam process, because it's become a statistical analysis.

I do think that it will foster some innovation by relieving some of the burden, but I would encourage as we implement the rule, let's start giving recognition to those process kinds of issues that are important to the overall growth and development and health of our communities, whether rural, suburban, or urban.

MEMBER DIEDRICK: Well, I think that's a good segue to a discussion of the proposed community development test and what is involved in this test. There is--we discussed whether or not--at the request of the staff--whether or not the elimination of the reporting data would be of concern in that we would lose something important that is used in analysis. There was one member who had a comment about that, but it didn't seem to be of tremendous concern.

So I'm going to throw this open to discussion of this proposed community development test that includes community development lending, community development investments, community development services, and I believe other types of retail banking services would also be looked at under this test.

And also I think it would be helpful for this committee to give some guidance into the weighting of the two tests, the lending test and the community development test.

Oh, Hattie. And then Jim.

MEMBER DORSEY: Well, I think there is a lot of concern about the community development test under CRA because we have utilized CRA in the activities of rebuilding neighborhoods and rebuilding communities and the involvement of major as well as small banks in that process.

I would say that without some measurable outcomes and the testing, that we would not have the opportunity to access the kind of loans and/or investments for community development if it was not required.

The other is let's think about why CDFIs really came into business. CDFIs were put in place because there was a reason that banks did not go into certain neighborhoods and lend. And so for the most part, CDFIs have paved the way to show to the banking community that there is investment opportunities and banking opportunities in neighborhoods.

So I would say that community development is essential as a part of the test, as a part of the review, and as a part of the act overall.

MEMBER DIEDRICK: I just want to say that unlike the OTS new rule that's been approved, this does have a community development test whereas the thrifts of the same size will have no community development test, so this seems to be much more progressive in that respect.

MEMBER MEEKS: I'm probably just repeating what people have said, but you know I think all of us in community development are really nervous that CRA and the community development test is being eroded. As one banker put it yesterday, it's a very important part, and she even felt like the walls were sort of crumbling in this.

And with us fighting this budget battle and community development has been hit very hard, I mean, this is just one more piece of this pie that does seem to be sliding away, so I would want us to look very carefully and, you know, banks I think I've always heard that they felt like they weren't getting credit for some projects that they were involved in that were really about community development. So you know I think there is some balance we can strike here, but I really do not want to see community development eroded.

GOVERNOR GRAMLICH: Could I make sure of what you're all saying--are you arguing that the introduction of a community development test is weakening the commitment to community development? Is that the argument being made? And if so, how?

MEMBER WILLIAMS: I'd like to address that if I can. I'm very concerned about the impact of the new test primarily on financial services and on investments. The good thing about the changes in CRA that occurred in the early 1990s was that for the first time we were looking at actual performance of financial institutions, not just their marketing materials or the kinds of programs that they offer, but how many loans are going into lower-income consumers and in lower-income communities?

And I think that it's important to continue looking at the performance of things within this new proposed test as well. My concern is that first of all branches, branch locations, are not being considered as part of the community development test, and branches are very important when it comes not only to financial services for consumers but also for small businesses.

And in addition to that, the service test is not as effectively implemented at this time as I think the lending test is. So, for instance, we know what kinds of programs and products the banks offer, but we don't know who the banks' customers are. Are lower-income unbanked people really being brought into the financial mainstream?

So that's my first concern. And then in terms of investments, I think that the investment test has been a very important tool not only for community development financial institutions, but also for banks. As Hattie mentioned, there are regulatory reasons why banks can't make certain kinds of investments. And CDFIs are able to do that, and what this test has done is it has strengthened the partnerships between mainstream financial institutions and CDFIs.

It's developed innovation; it's developed relationships and has really strengthened lending to lower-income and minority consumers. And so I think that as part of the implementation of this, that we also should remember to consider the performance of those investments as well.

MEMBER DIEDRICK: I'm going to have Kelly and then Stella.

MEMBER WALSH: I think that Marva made the points that I was going to make, but maybe one thing to add is while it's true that the investment test has helped the CDFI industry significantly, in our market there aren't any banks under $1 billion that have made any CDFI investments, so I think it would be worth looking at whether across the country that's reflective or not. If there were significant CDFI investments, made by those small banks, then maybe that should be reconsidered.

Otherwise, I just don't think it's their business, and

I think as Anne pointed out yesterday, having smaller institutions getting involved in some of these more complex investment transactions is challenging for them. Although it is creating innovation for the larger institutions, it might be more of a problem for the smaller institutions.

To echo the point about service delivery, as I read the proposal, retail delivery would be considered as part of the community development test, but it's not a focus and theoretically you--an institution could do a lot of things under the community development test and not have good retail service delivery and still pass. And the question is what are we really suggesting for our communities? You know, I think we've seen branches come and go over the years, and we generally have found that communities do better when a branch is there for lots of reasons.

It stabilizes communities, it brings in other players into markets, and so if you cannot have--if you can close branches and still do very well, so there's no focus on branches, that might be a problem for our communities.

MEMBER ADAMS: Well, that was pretty much what I was going to say.

The part of it--the community development test--I think the concern is that we're dumping service and investment inside of that community development test, and we want to make sure that retail branches are really considered important when the details are doved out by the examiners, that the focus is on those products and services that really help low- and moderate-income consumers as well as small businesses and small farmers in that.

So you need to have branches so that there are access to capital other than finance companies in these rural communities, in these underserved communities. And so that should be an important part of community development because where you have bank branches you will also have prosperity, you have--you can see changes in the community that are positive. And when those branches close, you can also see that community go down.

There's a direct correlation, so we just want to make sure that when we're incorporating all this stuff into the community development test that it still is important in the exam.

GOVERNOR GRAMLICH: If I could come back--I--I mean, this shouldn't be a debate, but one thing that has been a strong theme of this--the predecessor to this group in previous meetings on this topic, is flexibility. And you know we write CRA rule, and it's got investment test and a service test, and so there's always been a lot, at least in the comments I've heard, a lot of complaint about why don't you give us a little more flexibility and now the discussion seems to be moving away from that.

Has flexibility all of a sudden become unimportant? If so, say so. I mean, maybe we've misheard you, but--

MEMBER DIEDRICK: Well I feel like I have to jump in here. Flexibility is from a banker's perspective--flexibility in community development, lending, investment, and services is critical to sustainable--to a sustainable CRA. We currently have an investment test that stands by itself and counts for 25 percent of the rating. Community development lending is buried in the lending test. And services probably need a lot more attention; certainly community development services do not get a lot of weight in the services test.

We have been a big proponent of a two-part test for even large banks, over $1 billion, where we would combine all of the community development elements and give some flexibility to banks to do community development lending when it's needed and do investments when the opportunities are right and not just because they need to get the right number for the next exam.

This is crazy. To be running out and buying mortgage-backed securities for LMI loans that add no in back to the community just because you've got to add another $200 million to that column for the next exam is irrational.

So we strongly believe in flexibility, bankers--and we also strongly believe in community development. We think that we have a great responsibility to our communities, but we need flexibility in the rule, and so it's nice to see that this proposal for small intermediate banks has that kind of flexibility that we would like for all banks.

And then Mark, right.

MEMBER BREDEHOFT: I think my perception is that there isn't a concern about the flexibility between community development loans and community development investments that one could easily substitute for the other depending on the availability of community development loans and/or investments in a particular market.

The concern that I'm hearing from community groups is the services test, that they seem to want more emphasis on the services test because access to banking services is an important issue. So -- anyway that's what I'm getting from the discussion.

MEMBER DIEDRICK: Mark.

CHAIR PINSKY: Governor Gramlich, in response to sort of both of your questions, I mean I think there are some really good things about the new proposal. And I think that we all recognize that there is that--the less than $1 billion bank and that there are things that aren't being recognized and the ability to give some flexibility to that is a good thing.

You know my first reaction when I read this was something that happened with my sister once, who is a doctor, and she said she was once looking at a bag, I won't name the brand, but of enriched white bread. And she looked at it and she said, jeez, if someone took away all your money and gave you back 25 cents would you feel enriched, right? That was her comment about the white bread.

And so the reaction was you know CRA a year ago was--or six months ago -- was in great peril, we thought, right? And so we've come back from that a little bit, and I think that this Council had sort of urged the Fed to get together with as many regulatory agencies as you could and come to common ground, and you've done that, and I think that’s a really commendable thing.

I think that the--I guess I would make two comments about--the services test I'm not as expert on, I defer to other folks. On the investment test, I agree with you, Anne, that making a rash of mortgage-backed securities just so you can meet a number doesn't make sense; it's not a good thing.

In some cases, that's because the numbers come in and you suddenly say I've got to do more and in some cases in some banks, not you, in some cases it's a case that they just haven't been looking for those opportunities and so they are in a panic and they've got to find something and that's not good.

It's not good banking, not good lending. But where I would disagree with you, Anne, and where my concern is that I think extending the community development test to large banks would be a serious problem from my perspective. I think the large banks have the ability and have the capacity to know the markets well enough to go out and find those investments, most of the time. And maybe I don't understand all that large banks go through, and so for me there's a line there.

I think the other thing about this and hearing from staff and talking to staff is that I think that notion of flexibility and the focus -- the emphasis on innovation is really critical. Because I think we can learn a lot if we say to Bruce, you know, teach us about this, teach us about how what you're doing is, you know, through your innovation is serving community development, economic development in some way that maybe we don't understand. That there may be some opportunity to learn a lot.

MEMBER DIEDRICK: Anyone over here? I guess that's it.

GOVERNOR GRAMLICH: Well, not quite.

You mentioned data reporting, and, I mean, I think everybody understands that we're trying to balance competing goals and desires, etc.

There have been a lot of complaints about the data reporting at least for medium banks. I think the large banks realize that they're large banks, and they're going to have to do this. The medium banks it's not so clear.

We did put in something and the--in the regulation that's an invitation for you to comment that I'd like to make sure you've noticed if you haven't already, and that is if you can tell us how these data have ever been used in a productive way, please do so. I mean, we have not been able to come up with a huge inventory of answers to that question, but for those of you worried about the data reporting, we have meant to make that sort of like the open-ended question on an exam. Just tell us how you've used these data, and we'll factor that in.

MEMBER DIEDRICK: Governor, we did take that question up yesterday, and I believe Stella has used the data--

GOVERNOR GRAMLICH: For medium-sized banks?

MEMBER ADAMS: Yes, sir. I conducted the analysis of impediments for the state of North Carolina on a five-year basis and the data for medium-sized banks. In North Carolina, those are the banks that serve the rural communities, and so the analysis I'm doing is how access to capital happens in rural communities so that data is really important, and so it is very helpful in kind of identifying where small businesses are getting their lending as well as small farmers. And some of what we found is that small farmers were using their home for collateral instead of getting access to small farm loans. Using that data we've been able to encourage more banks to get involved with USDA rural housing, to get involved in doing those small loans, farm loans, so that folks are not in peril in their land and their home, using mortgage and oftentimes predatory mortgages to finance their farms when they should be getting farm loans.

MEMBER DIEDRICK: We also talked about the -- how important it will be if we go forward with this that the examination reports, the PEs, have this kind of information in it so that the community can read in a performance review of a bank how well that bank is doing in meeting the farm needs and the small business needs of the market. And I'm not sure how the streamlined exam would work in that respect, but that at least could be considered some type of substitute for the reporting.

MEMBER ADAMS: Yeah, I think we were talking about a table or chart or something in the CRA report.

MEMBER WALSH: With respect to the question about flexibility, I do think it's a good thing that more flexibility is allowed for the smaller institutions for the reasons Anne mentioned having to do with the sophistication, the need for sophistication, of investment products for smaller institutions.

But if we think about the weighting of those two tests, I think my opinion would be that the lending test should be the predominantly higher weight because it's the original intent of CRA and it's critical to the success of these markets and these applicants.

And then I think for the community development test, if it's a smaller portion of the overall weight of the exam, there should be--while there should be flexibility, there absolutely has to be a focus on retail service delivery.

MEMBER DIEDRICK: Does anybody else have opinions on the weighting of the two tests? Bruce, do you have an opinion on how these two tests should be weighted?

MEMBER MORGAN: No opinion on that, just try to get back to what was the original intent of CRA and make sure that what we're doing with our proposed rulemaking carries out that original intent. Our intent was to stimulate the development growth of our communities. Let's make sure it's there.

Now on the data issue, maybe I've misread it in the regulations, but we're not talking about changing the Call Report, do not collect that data. So the data are still going to be there once a year on small business and small farm lending, but it's how it's used in the CRA evaluation process. The data will still be there for community groups and others to evaluate to see what we're doing. I think we had a good idea at one time and we kind of strayed from the idea back and forth, and all I'm asking for is flexibility, Governor Gramlich, to recognize the innovations that we are trying to do to better our communities. Frankly, I have an economic interest in the development of my local community. Within a radius of my bank I have 45,000 households, 145,000 people, and if I don't do something to stimulate that area and its growth and development and stability, then that directly impacts me personally as the majority owner of my financial institution. So to say that we ignore these things is just not true, but to not give us credit for the things we do is not fair either.

MEMBER DIEDRICK: I just want to go back once more to the rural community discussion, and I think that what I've been hearing is that the LMI census track definition that we have been using we need some kind of an expansion of that definition when we're talking about rural communities to really encourage and incent banks to give them an opportunity to do more.

As Stella says, 80 percent of poor is poor. That's a good line. So that would be definitely one of our recommendations.

And I think the recommendation to consider retail banking locations, brick and mortar, and other alternative distribution channels for reaching the consumers in rural communities possibly using innovation is important, will -- should be an important component of the community development test from what I've heard in our committee and today.

MEMBER BREDEHOFT: Just to address Mark's issue of large banks, you know, I'm familiar with the large bank test, I'm comfortable with it, can deal with it, that's fine. But even for large banks, the community investment market is becoming tougher.

Years ago, we were able to compete in the low-income housing tax credit arena. A $30 billion bank really can't compete in that arena anymore as there are large investment companies, you know, coming into the state of New Jersey and outbidding us. So there are other investment opportunities that we have been able to take advantage of, but at one time in my old bank, those tax credits were our bread and butter, and at the time that our bank was bought, we weren't able to do them any longer.

So we need to be conscious of the changing environments and the abilities of banks of various sizes to compete for product.

MEMBER DIEDRICK: And I think from the large bank's perspective, it's--a lot of large banks are a little discouraged by how much they're doing in community development lending and yet sometimes they'll hear from the regulator, well, whatever you do in community development lending is really only an enhancement if you've done a really good job with your mortgage lending and your small business lending, you know, it really doesn't matter if you're doing community development lending because it's all about mortgage and small business. It's very discouraging to be a large bank to invest tremendously in doing community development lending and then know that it counts like for almost nothing in the final evaluation. Whereas the investments accounting -- you know it disproportionately at 25 percent to almost zero for lending. That's why we really thought it should be shook up a little bit.

CHAIR PINSKY: If I could just respond Susan. I understand that, and I just wanted to add to that, that I also think from the CDFI industry perspective and perhaps the CDC perspective as well--I mean, it's partly our obligation, too, to create new investment opportunities because I think that there's a way to do that and a means for doing that, but we haven't done that. We have to deliver product that, you know, for banks to have something to invest in. Because I understand that the banks look around and don't see the investment opportunities, and I think that's possible. So I--it's not a--I don't want to suggest that it's a one-way street. I think it's a two-way street.

MEMBER DIEDRICK: We know there are investment opportunities in CDFIs because we did I think last year almost $100 million in loans and investments to CDFIs, so we know the opportunities are there.

CHAIR PINSKY: We need more.

MEMBER DIEDRICK: Greedy. Anybody else? Stella.

MEMBER ADAMS: Just one other issue related to CRA that wasn't in the questions, but I want to commend the governors on including the section in there that says that it is possible to downgrade if you violate consumer protection and discrimination laws and want to strongly encourage in the weighting of the test that if you have been found to have significantly--and I don't mean a technical violation--unless there's a pattern and practice to it--but I mean that you have been found by the Department of Justice or the FTC or the state's attorneys general to have significantly violated or one of your subsidiaries has significantly violated these consumer protection laws, that you cannot receive an outstanding.

MEMBER DIEDRICK: Unless I am mistaken, that's been there for a long time.

MEMBER ADAMS: It's not written in--when they say how you can get an outstanding in the proposed reg, it doesn't have that sentence. I just want that sentence added, and that’ll be in my comments.

MEMBER DIEDRICK: Okay. Thank you.

CHAIR PINSKY: You all set, Anne?

MEMBER DIEDRICK: Yes, thank you.

CHAIR PINSKY: Thank you, Anne, and thank you for your committee. I mean, I think when this comes--I want to go back to the last meeting where one of the major points this Council made was that it was very important, as I said earlier, that the Fed and at least two other and ideally three other regulatory agencies get together that, that was very important I think from everybody's perspective and how that got done exactly we couldn't agree on, and I commend certainly the Fed and the other regulatory, the OCC and the FDIC for coming together on this.

I mean, the reality is you have an OTS proposal out there and you have a unified proposal from three regulatory agencies, so we'll see how this goes. This conversation may continue as well.

Dan, good news. If you need the extra time, it's yours to take. We'll go to 12:30 if you need the time. Dan Dixon.

MEMBER DIXON: Very good. Thank you. Thank you, Mark.

This issue for the next session is the advanced notice of proposed rulemaking that the Federal Reserve issued in December regarding open-end revolving credit regulation under the Truth in Lending Act. So let me tee up that discussion.

The Truth in Lending Act was first adopted in 1968 with a couple of major purposes. Number one, to provide meaningful disclosure of credit terms to allow consumers to compare terms of credit available in the marketplace effectively and to avoid the uniformed use of credit.

The second purpose was to protect consumers against inaccurate and unfair credit billing and credit card practices. The law has been amended a number of times over the years, most substantially in 1980, and, in fact, I think if the current version of the bankruptcy reform bill is ultimately adopted, there may be a change or two in the Truth in Lending Act deep into that document.

But the implementing regulation, Regulation Z, hasn't been comprehensively reviewed since 1982, so the Fed has embarked on such a comprehensive review. Consumer credit is a competitive business and a major component of the nation's economy. As a result, there are many credit providers, both bank and nonbank, bringing product development and creative marketing to bear.

Thus the market has seen many new products and pricing structures since 1982. Some of those have turned out to be effective innovations for consumer credit and maybe not all have been. Hence the question arises do the current rules still fulfill the purposes of the act, effective disclosure and adequate consumer protections?

In accordance with the rulemaking, the responsibility at the Federal Reserve, the ANPR was issued in December of last year, and comments are due March 28, so we were asked to provide some preliminary feedback to the Federal Reserve Board of Governors and staff today. And that feedback was teed up in the following three general areas. Would format changes be appropriate in the disclosures under the Truth in Lending Act? Can the content of the disclosures be improved? And, number three; is there a need to modify the rules to implement the act's substantive protections for open-end accounts?

Obviously, Regulation Z covers closed-end credit and credit secured by residential real estate as well as the open-end revolving credit. The Board prudently and appropriately is parsing this review and focused on open-end credit, so yesterday and this morning we've had and anticipate more discussion in response to these questions.

We have about thirty-five minutes, and we welcome your input. And we'll start with Diane.

MEMBER THOMPSON: This is not my main area of expertise. I don't spend a lot of time looking at open-end credit; I spend a lot of time looking at closed-end credit. However, it does seem to me, largely as a consumer of this information from my own credit card statements that the Schumer Box has been very useful in providing consumers with the consistent form of information for shopping from credit card to credit card to credit card.

As a consumer, I would find it extremely useful if the use of the Schumer Box provides standardized disclosures of the most important terms were carried over both from the initial solicitation to the application to the periodic statement so that it would be possible for a consumer to comparison shop from their current credit card to the solicitations they're getting in the mail and to quickly compare the solicitation they received with the final application.

So that they can make sure that they're not--there's no bait and switch at any step of the way without having to go through every bit of the fine print with a magnifying glass. I think it's particularly important to have the same format and consistency carried all the way through; it makes it possible for a consumer to be an intelligent shopper, which is one of the primary purposes of the Truth in Lending disclosures, to promote an efficient marketplace. You want to promote an efficient marketplace, you got to give the information to consumers in a form that they can use and that they can use without having to get their PhD in economics.

Or a legal degree.

(LAUGHTER)

GOVERNOR GRAMLICH: By the way, that would be better.

MEMBER THOMPSON: Well, I suppose it depends on how much of the discount rate you're expected to figure out and what the annualized APR over time is. Which is the other point that I would want to make, that when we look at what terms should be included in the Schumer Box, and we look at the kinds of fees that have been charged over time on credit cards, there's been a huge proliferation of the kinds of fees that are charged that are, in effect, finance charges.

From account opening fees to an increase on the interest rate if there's a default someplace else, to fees for late charges. I'm sure Clint will later be happy to advise of a long list of all the fees that can be charged on credit cards. But everytime I look at my statement or the change in terms or read anything about this, the list of fees just seems to have grown and grown and grown.

And, again, as a consumer, one of the things that you want for shopping is you want one place where you can compare what the real cost of this credit is going to be. And that has to be the APR I think. We've done a lot of work over the last thirty years and most consumers now understand that the APR is their shopping tool to compare the cost of credit.

In a study by--or the summary of financial education that we got written by Jean Hogarth of the Fed it says that 84 percent of consumers understand that if they're going to carry a balance the thing they need to look at on a credit card solicitation is the APR.

Given the proliferation of other fees, I think that one thing that the Board ought to look at and staff ought to look at as they go forward with the actual proposed rulemaking is perhaps some kind of average or typical effective APR that would include all of the fees that an average customer of the product that they're being solicited for pays.

So that the APR on opening credit would more closely parallel the way it is on closed-end credit. So on closed-end credit for a mortgage loan you can really tell somebody to use that APR as a shopping tool. It's going to include all of the fees.

The current APR on open-end credit just includes the interest, it doesn't include all the fees, and so there ought to be some way to do a typical or average APR so that a individual borrower can say well, okay, so here's the interest rate and here's what it's actually likely to look--here's what this credit actually is going to cost me. So that they're not put in the position of trying to say, well, okay so the annual application fee is--the annual fee is this much, the initial application fee is this much, the late charge is this much, the over-the-limit fee is this much, and the interest rate is this and what kind of complicated algebra then do I have to do to figure out whether this card or this card is a better deal.

And the APR has been used for a long time in closed-end credit to capture that, and I would like to see staff in their proposed regulations move toward some way of capturing all those fees going forward to simplify shopping for consumers and to promote efficiency in the marketplace.

MEMBER DIXON: Thanks. Forrest.

MEMBER STANLEY: Just two quick comments. I think for--disclosures have to be meaningful in order to have any benefit and one of the disclosures in--particularly on the periodic statement what's called the effective or historical APR I don't know if its originally provided value, but it seems that it at least has outlived its value. It is a very complicated number. It is given to the customer of course on a periodic statement after the fact, so it can't be used in a shopping mechanism or to avoid a fee and just to give a relatively simple example of that is if you have a--if you're carrying $1,000 balance on an 18 percent credit card and you incur a $3 cash advance fee, your historical APR I think goes up around 21 percent to 22 percent--forgive me. I'm on the lawyer side of the equation.

If you are a customer and the next month your balance is now $100, you paid it down but you've once again incurred a cash advance fee; your historical APR goes over 50 percent. Other than shock value, which I agree, that probably has for the consumer, I don't know what value that gives to the consumer. And it's--I think the one thing that we've agreed on the Council is that--over the years the disclosures have gotten so complex as to be less meaningful to the consumer because there's just so much there.

And this is--my second comment is this: as we go through this process, the ANPR had fifty-four or fifty-eight questions in it. It was a very imposing document. If at the end of the day, we end up with something that is smaller disclosures but more effective disclosures, I think we will have accomplished the purpose, but you know if we just end up with more, I think we end up--we continue down the path of kidding ourselves that the disclosure is informing the consumer; it's more confusing to the consumer, I think.

MEMBER CARTER: Thank you. I'd like to echo Forrest's comments and also Diane's about simplicity and I think simplicity and uniformity. The Schumer Box is, I agree, it's the best part of the disclosures required by the open-end credit provisions of Regulation Z, and I think it would benefit consumers greatly if it appeared not only on the applications and solicitations but also the account opening disclosures, periodic statements, and change of terms notices. Because at the change of terms point, that's also another shopping occasion.

The--as far as the annual percentage rate, one problem with Regulation Z is that the annual percentage rate is a different--is defined differently for open-end credit as for closed-end credit. As Diane pointed out, for closed-end credit it includes all the finance charges. For open-end credit, except for the historical rate, that Forrest mentioned, it only includes the interest rate.

And so consumers I suspect very, very few consumers understand that this is really a term with a different meaning in a somewhat similar context. I would urge the Board to consider instead of disclosing the interest rate in open-end credit using the term APR, use the term periodic rate or even possibly interest rate to tell the consumers that, that is just one component of the finance charge that you are going to pay.

I think it would be a wonderful innovation if a typical

APR, totally inclusive APR, including all finance charges, could be included in applications and solicitations as well as in the Schumer Box as well as other times the Schumer Box appeared.

For one thing, this is only to a minority of credit cards, but some credit cards are really simply means to generate junk fees for the credit card issuer. And the consumer cannot tell that very well from the APR, which may be zero. But actually this is a credit card that is going to generate huge amounts of finance charge in--for most consumers to whom it is marketed in the form of junk fees.

Giving a typical APR based on a year's worth of the historical APR is for a year's worth of consumers for that card, would give the consumer at least some warning that this is a credit card that is really designed to generate high finance charges through junk fees.

Using a typical APR would also address the problem Forrest brought out because while--for an individual consumer, the historical APR may go up one month and then down one month, it's 10 percent, it's 50 percent, it's 20 percent--if you average it out for all consumers, over a one-year period, it will--it will be an average, it won't be going up and down, it will be, in fact, I think, probably more accurate.

The other issue that is important to me and important on disclosures is the definition of the finance charge. The finance charge definition for open-end credit, I think should be a more inclusive definition. It should be right now there are a number of holes in the definition of finance charge. In fact, you could look at it as a Swiss cheese type definition. And I'm new to the Board, to the Council, but I think the Board has heard last year a little bit about bounced loans, and I don't want to reopen the whole bounced loan firestorm, but that's an example of holes that may--they may be just teeny holes in the definition of finance charge for open-end credit but that are just like a hole in a piece of fabric. As they work at it, they get bigger and bigger and bigger and pretty soon, you know, you have to throw your shirt away because it's got a huge hole in it.

So just for example, the definition of finance charge in Reg Z includes an exception for charges imposed in comparable cash transactions. That makes sense to me in the sense of a car sale. If I go in and buy a car on cash and on credit, and in both instances the car dealer charges me $10 for sending a courier to the motor vehicle department to get my license plates. That's a charge imposed in comparable cash transactions, and it's not a finance charge.

In the context of loan, the idea of a comparable cash transaction for a loan is a very tricky and confusing idea and maybe economists understand--I concede that there's a comparable cash transaction to a loan, but I have a lot of trouble understanding what a comparable cash transaction to a loan is. And I think the analogy breaks down and that the--in writing this--and that the Board should pay a lot more attention to that exception, which is allowed these bounced loans to grow up.

Another issue is the--there is an exception for NSF charge. Unless--it's not considered a finance charge unless the lender has agreed in writing to cover an NSF charge, to cover checks where there's no--not enough money in the account. And what agreement in writing has to do whether that's a finance charge I don't understand. This is an occasion the revision of Reg Z is an occasion for the Board to really look at the underlying definition of finance charge, rethink it, look at the holes that have grown up and close some of those holes.

So I welcome this opportunity to--for the Board to be looking at these issues.

MEMBER WALKER: Thank you. Carolyn, Diane. I agree in part, and I disagree in part. I totally agree that we need simple, meaningful, and uniform disclosures. It's harder to do than to say. With regard to the issue of format, that box, and we call it the Fed Box, we have a hard time using the word Schumer Box--it really works.

It has worked well, consumers have been trained over the years to look for it, and they do. And all our research is indicating that consumers are smarter about the use of credit cards than they ever have been before. You have a low-intro rate product; you see a lot of balance transfers, and a lot of surfing when that intro rate period is over.

You have a rewards product; consumers tend to transact a lot more to get their rewards. They are reading their solicitations, and they are using their cards in accordance with the way that the product has been generated. It really does work. Could it be better, yes. I mean, there are certain things, I think that are--one of the problems I have with uniformity is that some of the things that are statutorily required in the Schumer Box that consumers don't look at.

Minimum finance charge--consumers say they want to know how to--the payment calculation method that they--no one understands that. But there should be other things that should be in there. Fees, I totally agree. Put the fees in there, we put our fees in there. Consumers should know the fees, consumers should have simple understanding of what the APR is, and what the various basic fees that most people are concerned about. You shouldn’t put in things that most people aren’t concerned about. The basic stuff, it works. I also agree that it should be--we should have--some sort of Fed Box in the initial disclosure statement or the card member agreement. That works, in fact, most credit card issuers I've talked to are in favor of it. Our card member agreement, we have a chart in the back of it where we put all our--we laser in all our, you know, pricing. APR, various fees.

And I think it works. It alerts the consumer to the--those fees--and it does work. I don't agree it should be in a periodic statement because you're creating a massive headache. Every credit card issuer has multiple kinds of fees, if you have to do it; you have to totally change to format of the periodic statement. I understand the reason you want it, but I just think you're going to create a huge, huge issue in totally reformatting the disclosures you have to do on the front page. They wouldn't even get to the transactions until the second page. It would be a problem.

I agree with you, Carolyn, on change of terms notice. Put it in the change of terms notice. People should know what these--you know, what the product is. I think it makes a lot of sense. So you know I agree in large part about the format. The historical APR or whatever you want to call it, I think is really, really problematic. The way you have to do it now, the historical APR, is by definition inaccurate. It causes consumer angst, and they see an interest rate that they don't think they were charged, and the confusion, and it really does not work.

We've heard at this Council before that a lot of people like it because of the shock value. But that's kind of social engineering. That's basically saying, hey, we don't want you to use credit, and so we want to shock you into not using credit. I think that a very important part of Truth in Lending Reg Z is to provide informed and accurate information to the consumer and historical APR doesn't get there.

Again, the concept of Carolyn and Diane working about some sort of other kind of APR calculation--and then, by the way, I have no problem if you want to call APR interest to make it clear, that's fine. Making things clear is totally appropriate. But it is impossible because open-end credit is different than closed-end credit. People use it differently every month. What kind--their use of the product will determine what fees are charged and what--you know--what things--it's impossible to do a kind of like average APR calculation for all consumers. It totally depends on the use of the product. So I think the important thing is include your disclosure of the various fees so a consumer knows, you know, if they're going to do a balance transfer there is a fee with that, what it is. Put it up front, make it clear to them. But to put it in the kind of calculation where it changes every month is--or to try to do an average calculation where it has no applicability to that consumer I think is very, very problematic.

Just a couple of other little quick things in the point that the staff did in their very informative memo--they wanted the information about payment allocation. There's been a lot of litigation about that. I would just encourage the staff that if they do anything to make sure they look at that so that they don't put issuers at risk in violating what all the litigation on that subject has been similarly with the crediting of payments. Again, there's been a lot of litigation on that subject. I just want to make sure that anything they do, one, is consistent with that litigation and maybe provides--did you comply with it, you know, a safe harbor so we don't engender new litigation.

MEMBER DIXON: Mary Jane, did you--

MEMBER SEEBACH: Yes, I was just going to say my company doesn't currently issue credit cards so I don't directly have a dog in this fight, but I want to kind of look at this from a slightly different aspect, and, Dan, you know I'm the biggest fan of the Board, and I think everything they do is prudent and appropriate, but the one issue I would raise is I think looking at this review in a piecemeal way is not necessarily the best way to address this.

The open-end rules apply to both property secured as well as the credit cards, and there are rules that clearly, like the finance charge, like the APR, that cross over between credit cards and property secured that I think it's worrisome to think that the Board might make certain decisions now as to these definitions and have to revisit them later when we come back and look at the property secured and then maybe revisit again when we look at the variable rate aspects of it.

I certainly agree with simplification and uniformity in disclosures, and to the extent that we can see that across the rules, I think we're all in agreement, but it is worrisome that we're going to have to kind of do this in waves and keep revisiting some of the same concepts.

MEMBER DORSEY: Most of it's been covered; the only statement I would add is just to keep it simple so that the average everyday person can understand it.

MEMBER DIXON: Thanks. Bruce.

MEMBER MORGAN: This is a quite complex subject, and I compliment the Board and the staff for chunking it out, talking about open-end credit.

I've been an advocate in this Council that Truth in Lending is so complicated that the average consumer is not informed, but is confused by some of the disclosures that we hand out. And so what I would like to see a concept developed in this review is a summary on one page, what are the critical factors a consumer wants to know in making financial choices or financial decisions.

So a one-page summary. Last week Acting Comptroller of the Currency Julie Williams made a comment that bank regulators need to do a better job of understanding what information consumers want to know to help them make particular financial decisions. She went on to say the end result should be shorter disclosures, disclosures that consumers can understand, and disclosures that tell consumers what they want to know. So my second point besides a summary disclosure--I would encourage the staff and the Board to conduct some direct research with consumers about what information do they understand presently on the present disclosures, and what information or what critical factors do they think they really would like to know before they evaluate their various choices?

I'm recommending some focus groups--not one, but numerous focus groups with different types of persons and different types of--parts of the country. I'm also recommending using a Michigan survey, and I pointed out in our committee yesterday that Visa has extensive data that they've been doing annually for a number of years on actual consumer behavior. How they're actually using cards.

But as we look at this rule, I think we also have to look at the changes in Reg Z as it pertains to an evolving payment system. We just recently learned that credit cards are not used as much today as they were five years ago or ten years ago. So we're trying to make changes talking about open-ended credit, we've got to think about all of the open-ended credit products that are out there, have a simplified disclosure, and have a disclosure that's focused on information that consumers believe is valuable.

Right now, if I set down with one of my loan officers and said explain to me what this Truth in Lending disclosure really says, they're going to have a hard time doing that. If I sat down with a consumer and say what does this really say to you, do you really understand what this disclosure’s saying, it's very complex, so anything that we can do to simplify it--but we also need to recognize as I say the evolving payment system and the innovations that are going on and these disclosures may become less important as consumers use more and more electronic transactions whether it be debit, whether it be check conversion, direct deposit, etc.

So Reg E may be the more important disclosure in the long run; credit may be--on credit cards specifically may be less important because what we've seen is basically flat growth in credit cards and also a lesser portion of the total payment system’s pie. So let's don't forget the consumer in the discussion, and let's find something that is meaningful to the consumer because it is supposed to be by Congressional intent a disclosure act.

MEMBER DIXON: Sandy.

DIRECTOR BRAUNSTEIN: Oh, thank you. Bruce, I want to thank you for your comments, and I just wanted to say in reaction to your suggestions to the Board about finding out what consumers want to know that we are in fact doing that.

We utilize the Michigan Survey all the time on various topics, and this is certainly one where we're using it, and we do plan to do focus groups and some other kinds of things because we do want to get to exactly what kinds of information consumers want to see and what's effective for them.

MEMBER DIXON: Faith?

MEMBER ANDERSON: I'd like to add and reiterate Mary Jane's point that to the extent that you made changes in open-end that would effect closed-end or vice versa, you keep it open so that if you make a change in closed-end that would affect open-end, that you don't have to like reopen but you're just able to somehow just make the change if it's beneficial to consumers. And also we do support, you know, if what everybody has reiterated about listing all the fees on one page so that consumers can see what it is that they're being charged and when they will be charged and when the interest rate will increase.

And to the extent that we want uniformity in our disclosures, we believe that the Fed having more model disclosures would be a big help. And also to the extent that you're changing disclosures, it would be easier on smaller financial institutions if all the disclosures are done at once, versus, you know, do this disclosure now then in another year do another disclosure.

MEMBER DIXON: Kurt, you still--

MEMBER EGGERT: Yes, I've looked at informational remedies in a couple of different contexts, and sort of the basic lessons I've learned are that some of what people have brought up before is that first of all you disclose only a few most important information. The speed at which people get informational overload is enormous, so you want to focus on what's more--most important, which is typically price. And have a hierarchy of disclosures. So you want to have price right at the top so that people notice that first and then your other disclosures follow.

Secondly, you want to disclose in a way that's most personal to borrowers or to the person involved. If you say overall the prices are this that's useful information, but if they say to you the price is this, people will be much more interested.

And thirdly, you want to have consistent disclosures to the extent you can throughout the industry so that people can learn what the disclosures mean and how to use them. So they should be consistent in people sending out advertisements that's consistent with what you see on your personal existing accounts to the extent that open-ended and closed-ended accounts can be consistent, that's good, too.

So how do we apply these rules? I think one of the ways we apply them is to look at what do we most want people to know about their cards? And what they need to know is what's the basic interest rate, and I agree that, that shouldn't be called-- the base rate shouldn't be called an APR, it should be called something else like the interest rate.

They should know what the card issuers historical rates generally are, so if they get something from a different card they can say, well, you know their interest rate is low, but their historical rate is high, I don't want this card.

The third thing that they should get, and I think it's crucial, is a sense of their own historical rate. Now, I don't say they should get this for the shock value purposes, I say they should get this so that they can compare what they're actually getting with what people are actually getting in other cards.

And if you want to do that, you may want to change the number that they get. It may be that instead of getting just last month's APR, you give them instead say a rolling last six month’s APR. That way they can look to see, well, how is this card overall doing? If it's overall the APR is a lot higher than what I'm seeing elsewhere, I may want to switch cards.

And you do that in a way much more easy for the consumers than having them say, well, I had a 20 percent APR on a $100 balance and then a 10 percent APR on a $5,000 balance. It makes it easier for them to compare between one card and the next.

And the last thing you want to do is roll as many of their costs as you can into the APR so that when they're comparing the APR on their card with another card, they're seeing the full costs, they're not seeing, oh, here's the cost if you exclude these really significant costs that I'm getting dinged with every month. So I think you need to roll all those in.

Thanks.

MEMBER DIXON: Lisa.

MEMBER SODEIKA: Well I just--I wanted to support the-- Bruce's recommendation on reminding us all to listen to the consumer and what do our customers need clarity on? We had gone through a similar process on creating a one-page disclosure for our mortgage loans, and it was certainly important to do focus groups as you mentioned, Bruce.

A couple of other areas I'd look at are what are the advocates like Stella and Diane, when you're sitting down with the consumers, what are the things that are most concerning to them? So listening to the folks who are dealing one-on-one with consumers and issues everyday. And then along with that our own customer service records and complaints, even looking at why consumers are paying us off.

A lot of times, those things are happening because a consumer finds out about a provision that they didn't particularly care for or they didn't know it was in their loan and are not happy about that. So just to note that another avenue for listening to consumers is by looking at our own customer service inquiries and results, which we do everyday to try to get more efficient and better at what we do from a quality standpoint anyway.

MEMBER WALKER: I just want to talk real, real quick. Really in response to Sandy but also what Bruce and Elsie just brought up, and it's--relying on customers I think is very, very important--the Michigan Survey is great, customer service, you know, complaints are great. I just want to point out that in my business, the marketing department has totally done away with focus groups as predictive behavior. They might be helpful for, you know, generating ideas; might be helpful like--I was talking earlier just say, hey, I just can't understand this.

But to try to determine what disclosures impact what kind of behavior, our marketing department--and I'm told that it’s marketing departments of all credit card companies--do not do focus groups anymore because they just don't have any predictive value. And I've got some actual stuff in my comments to give you on that, Sandy, but I just wanted to bring that up.

DIRECTOR BRAUNSTEIN: Okay, good.

MEMBER DIXON: Anyone else? Oh, Stella, sorry.

MEMBER ADAMS: I just want to say disclosure is fine, but if disclosure doesn't tell me that if I send my payment in late that I am stuck in a cycle of unending debt that I have become chattel to the credit card company, that it's going to become negatively amoritizing on me, I can't ever pay my way out. Unless you're going to put that in the disclosure, it's not meaningful to the customer.

When customers make attempts--I think the changing of terms ought to stop when I stop using the card, that you can't then change the terms on me again so that if I find out that I'm overextended and I stop, then whatever those terms were at that point, and I'm starting to try to pay it down and pay it back, and I'm paying you every month, and I've paid you more than I've owed you, three times over, and yet I still owe you money, there's a problem that a disclosure did not disclose.

No consumer would voluntarily enter into an agreement where they're going to never get out of debt if they miss that payment deadline by a day. In light of bankruptcy reform and the new bankruptcy bill, this universal default, because I didn't pay Victoria's Secret on time, but I'm working really hard to pay my mortgage on time, to pay my Visa on time and to pay my major credit cards on time--because I missed that Victoria's Secret bill, because I figured I could pay that off next month, you're going to jump me from 7 percent to 28 percent and hit me with all these fees and then I can't get out from under and you're going to force me to pay you back fees on top of fees on top of fees.

There's got to be some re-evaluation of what is fair and what is unconscionable, and kind of the problem I'm seeing is that regulators and examiners say, well, it's not unlawful, but they forget the unconscionability of putting somebody in that kind of debt, which is also a factor in determining whether it's an unfair and deceptive trade practice.

MEMBER DIXON: I appreciate you personalizing those comments. I'm not sure we've got--we just got more disclosure than maybe we were prepared for.

(LAUGHTER)

MEMBER ADAMS: Somebody used that yesterday, and that’s what was in my mind.

MEMBER THOMPSON: Well, I think Stella's points make clear the need for substantive protections that don't currently exist. At the time that Truth in Lending was first enacted, most states still had the ability to effectively regulate the costs in terms of credit and for a variety of reasons, most states don't have that ability anymore and I hope it will become clear to the Board as they go through this process and as comments come in and as they review it, that there are existing abuses in the use of open-end credit and that it will be appropriate for the Board to go to Congress and request that Congress look at substantive protections in this area.

I think there are issues such as the use of this universal default clause that are very troubling. There are lots of concerns that many advocates have about marketing and marketing particularly to vulnerable consumers. There are concerns about how various--how change in term notices are used to change terms on people. All those things are beyond the scope of what can be done with the Truth in Lending disclosures, but I think it's important for us to understand that it used to be that the states could really effectively protect their individual consumers from these issues, and that is no longer the case.

Truth in Lending can't do that under the current statutory scheme, but many consumers do need substantive protections.

MEMBER DIXON: Anyone else? Thank you all for your active participation. I assume that as the rulemaking goes forward, we will have other opportunities to inform the governors.

Would the staff have any prognosis on when a proposed rule might be forthcoming?

MEMBER BREDEHOFT: No, not at this point.

You know, as you can see and from these discussions it's very--these are very complex matters, and it's a huge ANPR--it's probably one of the largest ones we've ever issued, and these issues are going to take time to sort out, so we're looking forward to the comments, though. And this group will be discussing it in future meetings, you can be sure of that.

MEMBER DIXON: Thanks.

CHAIR PINSKY: Thank you, Dan, thank you to the committee; I want to commend all the committees and all the Council members on two very good days of discussion. We've made some significant progress and learned a lot.

Now we get to sit back and make Bruce do the work. Bruce is going to present. Everybody should have at their seats a copy of Bruce's presentation and thank you, Bruce, for doing this.

MEMBER MORGAN: I've got a few items that I wanted to share with you about community banks and how they're a little bit different in the banking industry, strategic challenges facing them--I prefer to just use the term regulatory burden, I'm not going to be lengthy on that today.

Anne wanted me to do a case example--she wanted me to talk about some specific things that a community bank actually does in terms of investments or loans and what the outlook is.

The banking industry historically has had a number of small institutions. It's grown up historically because of the new banking system, the national charters versus state charters. I use the term chartering has been permissive, and maybe that's not a good term, but having served two terms on our state banking board, if you brought in the capital and you had a reasonable business plan, we granted you a charter, and OCC has done the same thing in terms of national banks.

I'm talking about institutions primarily less than $1 billion and typically the community banks do most of their business in a small geographic area. When I say community bank, besides being below $1 billion, most community banks are generally locally owned and managed, they focus on consumers and small business. In fact, all the statistics that I'm presenting today are as of December 31st '04.

Thirty-three percent of small business loans are in community banks; 40 percent of small commercial real estate loans are in community banks. Community banks still have the ability to attract retail deposits. In fact, 24 percent of all deposits below $100,000 are in community banks. The Board of Governors for a number of years have done bank fee studies and generally, community banks have had lower fees in the fee study reports to Congress, and we typically have paid higher rates on deposits, CDs, savings accounts. Which again has been beneficial to consumers.

Community banks provide personal service to customers. That's our business model, that's our whole strategy. We have local connections, local knowledge, and local resourcefulness. And just over--a little over ten years, since '92, there's been 1,250 new de novo community banks formed across the country. Only four of those have failed.

Now what you will find about community banks is they typically have no plans to open offices in Europe, the Far East, or the Middle East. They don't engage in complex transactions, mergers and acquisitions, debtor and possession financing, high risk financing, securitizations. They typically don't acquire or engage in businesses only marginally related to the core business of banking. And the core business of banking is lending and taking deposits.

We operate in niche markets, we operate in local communities, and we are involved in both local community and economic development efforts. Now in the industry, the number of institutions the last decade--well, really more than the last decade, but in the last decade there's been a decline in the number of institutions from roughly 13,000 to just under 9,000 at the end of '04.

When we look at community banks and how they fit into that, 93 percent of the total number of institutions are banks below $1 billion in assets. Ninety-three percent. Almost 8,400 institutions.

You see, there are only 117 institutions that are greater than $10 billion. The industry assets, however, are concentrated in the larger banks. While we represent 93 percent of the total institutions, community banks represent only 25 percent of the total assets, and those 117 institutions represent roughly 73 percent of the industry's assets.

The largest concentration of community banks is in the Midwest. If you take the three FDIC regions that I've identified here, Chicago, Kansas City, and Dallas--they comprise 65 percent of all of the institutions in the country. Take the state of Kansas in which I'm located.

I'm one mile from the Missouri/Kansas state line. We have 355 banks in our state and 349 are community banks. The state of Missouri? We have 345 banks, 338 are community banks.

Let's talk about what kind of assets we have. Flip over here, a couple of more slides. I'm going to try to rush this along so we stay on schedule. Community banks primarily loan to consumers. If we look at the composite loan portfolio, 28 percent is residential mortgages, 25 percent commercial real estate, 14 percent is commercial/industrial. Agriculture, 3 percent; construction lending--and primarily construction lending on one-in-four families, 11 percent; credit cards, 1 percent; other consumer loans, 7 percent.

How do you compare that with the larger banks? Slide. If the slide will cooperate. Larger banks have a slightly different loan portfolio composition. While residential mortgages are 30 percent, you see that credit cards and other consumers represent 17 percent of large banks' composite loan portfolios.

You see that commercial real estate is smaller and that category, all other loans, is large. A lot of things get lumped into that. And construction is five percent and agriculture doesn't even amount to 1 percent.

So in terms of the types of loans that community banks do versus larger banks, there is definitely a difference.

There's also a difference in profitability. Community banks have a slightly lower return on assets; 101 versus 119, 144, and 128. Community banks have higher net interest margins. Now while this is important to understand the higher net interest margins are biased toward the community banks focus more on lending and retail deposits in their core business, but it also makes them more sensitive to changes in interest rates.

So as the Board of Governors changes rates, it has an impact on community banks’ net interest margins. Large banks rely more on fee income and fee income businesses. A study by the Bank Administration Institute a few years ago asked consumers, why do you change accounts? Because it's really kind of a pain to change your checking account from one institution to another.

And the number one reason cited by consumers was the bank fees. But in this 232 fee there is a lot of other things in there other than just fees on checking accounts. Community banks have higher overhead. Part of this difference might be attributed to economies of scale, but a growing problem is the disparity in the increasing costs of compliance. For the last six weeks, my entire staff has been consumed preparing for compliance exams. Both external compliance auditors and today, FDIC.

Twenty percent of our pretax earnings in 2004 was spent on audits and regulatory compliance. And between February and July, we will have five separate audits in our community bank. That takes time away from us making loans to consumers and small business.

If we're totally consumed in compliance and audits, then we don’t have time to meet with loan customers; that's why it's a concern.

We have higher capital ratios, and higher capital, non-complex traditional banking--it poses less risk to the overall financial services industry, but it also means that we return a lesser return to our shareholders and investors.

So to kind of summarize, 93 percent of the number of institutions, 25 percent of the assets. Largest concentration in the Midwest and central states; the industry assets are concentrated in large banks, primarily located on the coast.

Almost 90 percent of the total loan portfolios of community banks are in these areas: residential mortgage, small commercial real estate, construction loans on one to four families, agriculture loans, and consumer loans.

And the final point: we rely heavily on net interest margin, have lower fees, higher overhead, and higher capital ratios.

Now the chairman had talked about a conundrum. And what I propose to you that a conundrum is the community bank. Despite industry consolidation, new nonbank competitors, certain bank products becoming commodities, community banks still prosper. Why?

Well, because of the growth of de novo charters. They steadily grow each year due to the willingness of private investors to risk their own money to create new banks. And what we've found in our part of the country in the Kansas City metropolitan area--those new bank charters have been concentrated in areas where large distant banks have acquired or taken over local institutions.

Each new wave of large banks mergers has created a number of new bank start-ups in our area. And the success of community banks, de novo community banks, suggests that customers prefer the personal approach and services offered. A bank, for example, at 135th and Antioch in our community--it took the organizers ten days to raise $6 million to start a new bank.

Their eleventh month in operation, they were profitable. Today they are about $135 million in total assets, and the average asset size, and averages, you know, like what is beauty? The average community bank across the country is about $140 million in total assets.

Federal Reserve Bank of Kansas City, for a number of years, has periodically done a survey of community banks. These are the strategic challenges that they've identified in order of importance that community bankers have identified that will face them the next five years.

Down the list, meeting regulatory compliance, dealing with technological change, loan growth, maintaining retail deposits, the same kind of issues some of the larger banks in the room are concerned about.

However, this is the order of greatest regulatory burden to least regulatory burden that was cited in this 2004 study. As I mentioned earlier, it diverts time, money, from our core business, which is lending to consumers and small business to dealing with auditors.

Now we're not advocating no regulation. We understand we're in a regulated industry. But what we're asking is a common-sense approach, more collaborative examination processes, and less adversarial and punitive approaches to the examination process. And the recognition by the Federal Reserve and other regulators that some data that we gather from small institutions aren't very meaningful.

For example, on the HMDA data, a bank with less than $100 million in assets, you're going to have ten to thirty loan application register items. Ten to thirty LARs. Now Glenn Canner's 80-box matrix, which box do you want to put those eleven LARs? And what does that really tell you?

If you exclude those banks from HMDA, you would capture about 97½ percent of the total industry assets. Just a thought. One that probably will not happen in my lifetime.

My bank was founded in 1969 in Atchison, Kansas, by local business and community leaders and the bank was founded because big banks would not make home loans in that local community, so they started their own bank, thinking they knew what they were doing. Present management--myself--acquired the bank in July of '93. We branched into the Kansas City metropolitan area in January of '95, located our main office there in 1999.

In fact, here's what a community bank looks like. Thirty-two degrees, 11/23.

(LAUGHTER)

This bank building is a building that we got involved in a redevelopment project on block 19 in our community, and we built a building to eat a building. Lisa's company had a bank there, and this window here used to be the front door, and there used to be a drive-up coming out this way, and so we built a 10,000 square foot building just to eat her old household bank building that was called, at the time, at that location.

Now if you look at our year-end data, we have about $45 million in assets so, you know, I kind of generalize and say $40 million in assets. But our business model is a little different. Two years ago, we originated and sold $120 million in loans. We closed loans in twenty-six states. From Carmel, California to Ft. Lauderdale--from Butte, Montana to Padre Island.

We're located primarily in the Kansas City metropolitan area in an older inner-ring suburb. We're five minutes from downtown, we're one mile from state line. The demographics of that primary trade area that you find for our bank I call the newlywed and the nearly dead. We have young professionals, couples, single persons, single parents, but we have people that want a high-tech, high-touch experience when they come into the bank.

Our primary niches are real estate, one in four family, and portfolio secondary market, loans, home equity lines of credit, business loans, small commercial real estate, small commercial leases.

Technology is how we can survive in this environment. We have a state-of-the-art core processing system, high-speed Internet access, transaction web site; we do everything we can electronically. ACH, debit card transactions, credit card transactions. We've been imaging checks since '99. We have all of our loan documents in a document management system. Every place we can to eliminate paper and move to electronic delivery options, we have, including ATM networks, debit cards, credit cards, and the transactional web site.

Our assets, 67 percent loans. Now this was down at year-end because on the thirty-first day of December one of my customers sold themselves to a company in California, and so we suddenly had $10 million in loans to pay off in one day.

We won't belabor that. Let's talk about three cases--

commercial printer. Entrepreneur wanted to start his own office in commercial printing business, office supply and commercial printing business for banks. His customers were banks. He went to a big bank loan officer. After hearing the loan proposal, the loan officer told him you need to go get a job so you can support your family.

He talked to the banker, and he's been my customer for eighteen years. We've helped him in start up, acquisition, growth, acquiring buildings, acquiring new equipment technology, and expanding into new product ventures. He's a $3 million plus in sales business in North Kansas City, Missouri. He employs thirteen persons and he's one of "Corporate Reports" top small businesses in 2004.

The two buildings here -- main building, the building adjacent. This is a state-of-the-art technology that takes from computer to press, a Heidelberg Five Color Press. This machine here is a flex-o-matic packaging machine, there are only four of them in the United States, and they produce 500,000 bags a month for one customer that sells pet treats with that new technology.

Another example, nursing facilities and assisted living facilities. Community banks have to find niche markets. One of my niches has been health care finance. I have a customer that his business model was to acquire a troubled nursing home adjacent to the metropolitan area, turn it around, and in the same community or adjacent community, build an assisted living center for the frail elderly.

We started with him in 1995; his business model was urban census, rural labor force. On December 31st he sold eight skilled nursing facilities, eight assisted living facilities, and twelve communities for $42 million. This is the last assisted living center facility, and when you look at one of his facilities, it's the nicest place that some of the frail elderly have ever lived in.

The troubled nursing home looks like a typical Hill-Burton type nursing home in a rural community, but when you walk inside, the look and feel and staffing is totally different.

CHAIR PINSKY: Bruce, I just want to ask if you can try and finish up in about three or four minutes. Sorry. Thanks.

MEMBER MORGAN: I won't talk about the urban renewal. I won't talk about the college. We'll go to the conclusion.

What do we want from the Federal Reserve? Efficient, affordable, moderate payment system, continued access, recognition that payments is a business and that the community banks are the Federal Reserve's customers, consistent transparent monetary policy, recognition of community banks' role in community and economic development, and moderate the impact of regulatory burden on small, well-managed community banks engaged in traditional core banking businesses.

The outlook is positive. Why? Because the spirit of entrepreneurship--a community banker invests and risks his or her personal assets in meeting credit needs of local communities. Consumers and small businesses continue to vote with their preference for high-tech, high-touch banking but locally managed and owned community banks and technology is the great leveler.

Final comment: Chairman Greenspan's remark--I have no doubt that thousands of smaller banks will survive the consolidation trend reflecting both their individual efficiencies and competitive skills on the one hand and the preferences of the marketplace and the personalized service on the other. Thank you. Sorry I ran over.

CHAIR PINSKY: No, that's all right. Thanks; I'm sorry I had to--

(APPLAUSE)

Let me just see if there are any--particularly if any of the governors have any questions--one or two questions we may have time for. No?

Anyone else have questions for Bruce? I have a feeling Bruce would be happy to talk more about community banks to anybody who wants to talk to him. That's great, Bruce, thank you.

Our final order of business is just a quick summary, committee reports from yesterday, and I think we'll just do it in the same sort of order we went through today.

So Mary Jane if I can ask you to go first very quickly--other topics discussed and future meeting items.

MEMBER SEEBACH: Certainly. I assume we'll talk about HMDA again. We're also going to be looking at in anticipation of the 2006 HOEPA hearings; we'll be looking at mortgage lending practices and product features. Basically, those that may have the tendency to lead to what might be termed predatory lending. Examples might include prepayment penalties, interest-only loans, failure to escrow, those kind of practices and/or features that may have--be more problematic.

In connection with that, we're going to be looking at foreclosure rates and where those are higher for certain types of products.

As a related topic, we're also going to be looking at affordable housing, and we are going to be teeing that up for the Board as it relates to the Fed's impact and interaction with GSE policy. We're going to be looking at first-time homebuyer programs and what's causing the higher rate of foreclosure there.

We're also going to be looking at the impact of the budget proposals on available, affordable housing subsidies.

CHAIR PINSKY: You're going to be busy. Okay, thanks. Forrest.

MEMBER STANLEY: Yes, we had two other discussions yesterday. One was more or less just an update on Check 21. The other one was around the electronic delivery of financial products. One of the things that I mentioned at the meeting is that we sent out e-mails today to--for our online banking to remind people that their monthly statement is available.

That has been a source of a great deal of phishing; people have phished that--they make it look exactly like our statement, except they also ask for the ID numbers and that is an unintended consequence of providing an e-mail alert for a periodic statement.

Going forward, we'll still be looking at Check 21 since it hasn't been used a lot yet, we haven't had a lot of feedback because it's just still less than one percent of the transactions are going through that way. We'll be talking about BSA, know your customer, particularly from the consumer perspective.

A couple of--we will be talking about electronic fraud phishing and check fraud. And two new topics that were brought up by some of our new members. One is prompt re-crediting of credits for signature-based debit. And the other is privacy concerns where merchants are swiping information off of debit and credit cards and using that or losing that and the consequences of that.

CHAIR PINSKY: Thank you, Forrest. Anne.

MEMBER DIXON: The other couple of topics we covered yesterday included--I'm sorry--did you say Dan?

MEMBER DIEDRICK: No, Dan sounds like Anne.

CHAIR PINSKY: I said Anne, but I must have meant Dan, Dan.

MEMBER DIXON: I’m sorry. Go right ahead.

MEMBER DIEDRICK: No, no, Dan. I defer.

CHAIR PINSKY: You're on a roll, Dan, go for it.

MEMBER DIXON: Not only is he blind, but I'm deaf.

(LAUGHTER)

We talked about some of the FACT Act regulations that are still pending, and that discussion will continue on some of the same subjects and maybe some others going into the June and perhaps even October meetings.

We talked some about, I think, almost as Mary Jane suggested there--some of the newly developing practices in mortgage lending which have the potential and maybe in practice already are turning out to be predatory. Some of those practices are associated with adjustable rate mortgages, which have become more popular in the current interest rate environment. But from one perspective, there's a benefit in the rising rate environment and another perspective there's a risk.

So that discussion I am sure will also continue. A couple of other items that we expect to work on in the coming meetings, there will be more conversation obviously on the Reg Z review because the comment period will have expired and we'll get a summary of the comments that the--that are submitted.

And in addition to FACT Act, we had a couple of other items that we think may deserve some time. One is we have some interest in trying to get some analysis of the type of consumer concerns and complaints that come through the Federal Reserve. Obviously, there are some banks for which the Federal Reserve might have direct supervisory oversight; others get referred to other agencies. Some banking, some not so—-but, hopefully, there is some tracking and analysis that takes place on those consumer inquiries, and it might be educational for us if we could get a review of that.

DIRECTOR BRAUNSTEIN: We will have that at the next meeting.

MEMBER DIXON: Great. And then finally, there is a new concern around live check solicitations which fits somewhere in the mix of consumer credit and depository products and services.

CHAIR PINSKY: Thank you, Dan. Let me try again: Anne.

MEMBER DIEDRICK: We will also be coming back to HMDA in June taking a look at some of the early studies that we expect to see out by some of our colleagues here, including Woodstock and others who we know are going to rush to getting their analysis out in the market. We know there's a little bit of a feeding frenzy on the data from the community groups and even some in the press since many of us have had multiple requests for this data.

So we'll be coming back to HMDA again, probably throughout the year. And clearly we'll be coming back to CRA as the comment period will have been completed in May and review the type of comments that have come in on the proposal.

So I think those will be the two major items that we'll be taking up and, of course, anything else that the staff wants to look at on the compliance end.

CHAIR PINSKY: Great. Thank you and thank you all.

We will be convening as we do on a regular basis, our committees, to do planning for the upcoming meeting. So you'll look for e-mails and contact from the staff who will organize all of this and distill this all into something.

And we will get together again in June, I guess, is our next meeting, is that right? I just want to remind folks--and Sandy, I don't know if you want to say more about the upcoming research conference or just to tell people that it's coming up. I think the April 7th and 8th--

DIRECTOR BRAUNSTEIN: Seventh and 8th. April 7th and 8th in Washington, D.C. The focus of the conference is consumer finance. Who is being served and at what cost, basically, and there is a lot of very good papers on the agenda. We had brochures available I know yesterday for all the members, and I don't know if we have some over here today or not. We may--we do. I'm getting a yes, so we do.

And you're all welcome to attend, not free, of course, but you're welcome to attend.

(LAUGHTER)

CHAIR PINSKY: I want to thank all the Council members. I want to thank the governors for your time and for participating with us, and I neglected at the beginning to thank Lori who I've been working closely with and look forward to continuing working closely with.

For Council members, lunch is--I think down the hall here, right? At the usual dining room at 1:00--so in a few minutes. Thank you all.

(Whereupon, the above-entitled matter was concluded at 12:57 p.m.)