TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING
THURSDAY, OCTOBER 27, 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
Lorie R. Swanson, Vice Chair
Stella Adams
Dennis L. Algiere
Faith L. Anderson
Susan Bredehoft
Shiela Canavan
Carolyn Carter
Michael Cook
Donald S. Currie
Anne Diedrick
Hattie Dorsey
Dan Dixon
Kurt Eggert
James Garner
Chuck Gatson
W. James King
Elsie Meeks
Bruce B. Morgan
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
Roger W. Ferguson, Jr., Vice Chair, Board of Governors
Susan Bies, member, Board of Governors
Mark W. Olson, member, Board of Governors

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9:02 a.m.

CHAIR PINSKY: Good morning, everyone. We'll come to order for the Consumer Advisory Council. I want to welcome everyone this morning. We had a very productive day of committee discussions yesterday. We're looking forward to a busy agenda and a productive discussion today.

I want to welcome Governor Olson today and Vice Chair Ferguson. Thank you. I know Governor Bies is on her way over. We look forward to her participation as well. You all have a copy of the agenda and we've reviewed this but let me just make note of it. We are going to spend about an hour we think on the Home Mortgage Disclosure Act that we had really the first time as a council to review the data that staff had pulled together in their analysis of that. We spent a fair amount of time on that. Looking forward to that discussion.

At about 10:15 a.m., we're going to talk about the Economic Growth and Regulatory Paperwork Reduction Act otherwise simply known as EGRPRA and we'll have a good discussion about that. We'll take a brief break. We're going to come back and talk a little bit about nontraditional mortgage loan products and we'll see how that discussion goes.

Then we added to the agenda with the Governor's consent a discussion around the issues that have come up around Hurricane Katrina and it was as a CAC issue a challenge to figure out how to take all the things that were going on and figure out how to bring them together. We did a lot of that. Our Vice Chair Lori Swanson really took leadership of that and she'll lead that discussion.

Before we start, I want to just acknowledge the ten members of the CAC who are serving in their last meeting and thank them all for their service. At the end of the meeting, I hope to have a little bit of time and anyone who wants to make a few comments we'll try and do that. But let me acknowledge Susan Bredehoft, and everybody's moved around so I have to find you here, Dan Dixon, we lined them up, Jim Garner, Chuck Gatson, Jim King, Elsie Meeks, Ben Robinson who is not able to be with us today, Diane Thompson and Clint Walker and myself. Thank you.

With that, if there is not other business, I think we're going to dive in and get a headstart on things. So I think Mary Jane is going to lead us off in our discussion of the Home Mortgage Disclosure Act. Thank you.

MEMBER SEEBACH: Thank you, Mark. In 2002, the Federal Reserve Board

Act amended its Regulation C to expand the type of information that lenders covered by HMDA must disclose to the public. The amendments were intended to improve the quality, consistency, and utility of the reported data and to keep the regulation in step with developments in the home loan markets. Specifically, the 2004 reported data, the lenders are now required to report pricing data for the higher priced segment of the home loan market, a segment that was virtually nonexistent fifteen years ago, but which is now an important part of the overall home loan market.

In March of this year, the Consumer Advisory Council discussed the implications of the soon-to-be released data. It was generally agreed that meaningful discussion would be possible once the FFIEC released the data for all reporting institutions and the Federal Reserve released its much anticipated article and analysis of the HMDA data. Much of the Fed's article focused on the various new items included in the data but the main focus of the media, industry, and advocates has been on the incidence of higher priced lending and the comparison of prices paid by borrowers grouped by race, ethnicity, and sex. Speaking very generally, the article concluded that minorities received higher priced loans more frequently than nonminority borrowers. It also concluded that HMDA data on its own is not sufficient to reach convincing conclusions about whether unlawful discrimination has occurred.

At the same time that the Board was conducting its analysis, lenders, and consumer advocates were also analyzing the data and reaching their own conclusions. Our discussion today will begin with a review of the types of reviews institutions and advocates have undertaken using the new data.

I'm going to start off the discussion to talk about what Country-Wide Home Loans has done with its data. And I've done a number of speeches on this over the year so I'm getting quite good at this. Basically, the Federal Reserve set forth some standards on what they thought each institution should do and we all of course adhere to that. We started with a review of our own internal policies and our own internal mitigation plans and we've reviewed those to insure that we were confident that they were continuing to deliver according to the risk analysis that we'd all undertaken for our institutions.

We then did what the Fed encourages us to do which was to begin to understand the market impact and the market opportunity that was available with the new data. For us that meant that obviously as with any analysis, we all undertook a look at our denial rates and our rates of distribution for minorities, so for African-Americans versus whites in any particular MSAs or

Hispanics.

We also introduced what we now call the SDI versus the DDI. The SDI is the Spread Disparity Index. I'm trying to do what I can to introduce new initials for the government and we looked at our performance in a particular MSA and then we also looked at our market presence in that MSA. So we compared ourselves to the competitors, the main top lenders in each of the MSAs. We looked at their DDI, also their distribution rate and their spread disparity index.

At the end of the day, we have a snapshot of each of the MSAs especially the top MSAs in minority lending and can take a look at our performance in each of those categories and then work with our business units to identify if additional market opportunities are there and how they might be achieved. So that's the approach we've taken.

I'm going to turn now to Marva Williams who's there and she's going to talk a bit about what Woodstock has undertaken in their analysis.

MEMBER WILLIAMS: Good morning. The Woodstock Institute earlier this year requested the lending data of twenty of the top lenders in the Chicago region where we have our headquarters and these institutions represent about 50 percent of the market in the Chicago region. I'd like to share some of the major findings of our research.

We found that minority borrowers were more likely to receive subprime loans but minority borrowers are more likely to get a subprime loan regardless of their income, that the subprime loans are concentrated in minority census tracks and last, that middle income minority census tracks have the lowest share of prime loans.

In our research, we acknowledge that there are several factors that are not included in the HMDA data that may impact the pricing of a loan and its underwriting. However, we are also aware that seemingly objective criteria like credit scores and other kinds of criteria are embedded with social factors and characteristics that may make them biased against minorities and low income borrowers.

I'd also like to mention that the Woodstock Institute annually produced a community lending fact book. The fact book describes mortgage lending in each neighborhood in Chicago and next year, we will be expanding our fact book to include Cook County as well as metropolitan communities throughout the State of Illinois and the pricing data will be part of that community lending fact book.

We think that this data is very valuable, that it's a very important component of

mortgage lending and that it has significant influence on our plans for policy development as well as for education of consumers, regulators and government officials and can also help in our relationships with financial institutions in developing more appropriate products for lower-income consumers.

MEMBER SEEBACH: I would like to open it up now. We've hoped to lay out at least as a starting point how lenders have started using it and the advocates have started using it. There are obviously a number of policy implications here that we'd like to open up to the whole council to have a fuller discussion. Ann, do you want to talk a bit about what you all have been doing with the data?

MEMBER DIEDRICK: Sure. I'd love to. We were very lucky enough yesterday to have Bob Cook come and share with us what the Fed does to prepare for fair lending exams and the type of analysis that the Fed goes through to really drill down to what it wants to look at in a fair lending exam and this analysis is also made available to the other agencies on their request and we spent quite a lot of time looking at this.

The purpose of the analysis is to try to explain the disparities by product, by race, by a lot of different factors and this is exactly the type of analysis that goes on within at least all the major lenders that I've spoken to. I know Country-Wide does this. HSBC does this.

But then we have the ability also to start layering on that analysis information that is not contained in the public HMDA data but also contains things like FICO scores, product types, loan-to-value ratios, those types of things with the idea that we are trying to eliminate, get down as close to zero the disparities that we see in this data. So we had some sharing of how we do analysis yesterday. I thought it was extremely helpful and I appreciate Bob Cook's time that he spent both in my committee and in Mary Jane's committee.

MEMBER SEEBACH: One of the things I think we all recognize is that this is really just the beginning of the discussion. There is so much more to be gleaned from the data. Even the discussion yesterday with Board staff about what additional factors were most predictive, I think, is beginning a discussion that we will all continue to pursue as we understand how the data can best be used. Hattie.

MEMBER DORSEY: How we're beginning to use the information is to educate the community development corporations, many of the communities that are involved in working with the banking community about what is going on and what this pricing really means to that end of

utilizing the relationships that I have made around this table by inviting Marva Williams and a member of her staff to come and really talk about HMDA and what it really means to the purchaser of a home loan.

It's not so much from my point of view of being angered by the fact that I walk into a bank and that as a person of color that I might get a different price quote as what do I do about it and how in fact do we begin to educate on the banking side as well as on the consumer side what is in fact fair and equitable. So persons who are community activists and not in the banking realm, to us the information is golden as to how in fact to structure better relationships, how to get past the concerns that we may have that even though we are middle-income, and I would classify myself as middle-income, that I am quoted often times a higher price based on job or based on the fact that I live in a certain community.

CHAIR PINSKY: Mary Jane, if I could just one second. Governor Bies, welcome.

MEMBER SEEBACH: Yes. Welcome. Diane.

MEMBER THOMPSON: Thank you. I think it's important that we start any discussion about the HMDA data by first looking at the big picture here because the big picture is perhaps not surprising but I think it remains shocking and has serious significant policy implications in many areas for this country. I don't think that we do ourselves a service by trying to peel away that big picture in teeny tiny little chunks and to explain it away. I think instead of explaining away the big picture what we want to try to do is change the big picture.

So what's the big picture look like? Thirty-eight point six percent of African-Americans versus 9.4 percent of white/non-Hispanics are likely to end up with a subprime home purchase loan. Thirty-three point five percent of African-Americans versus 10.9 percent of white/non-Hispanic Americans are likely to end up with a subprime first lien refinance.

What that means is that if we assume a mark-up of 300 basis points just to get to subprime and we assume an average home mortgage of $150,000, we're looking at home purchase African-Americans paying a premium of approximately $60 million in interest alone a year. It's not points. It's not fees. That's not prepayment penalties. So African-Americans at a point in time when we are purportedly dedicated to decreasing the asset gap between whites and African-Americans are paying for the privilege of becoming homeowners and building their wealth an extra $60 million a year in home purchases.

That's money that could have been used to increase the home they purchased. That's money that could have used to pay down principal. That's money that could have been used to put into college savings funds or in other ways to build wealth.

The numbers are similarly stark in the refinance section. It works out to be about $47 million extra in interest. Again, that's not including the excess fees or the excess prepayment penalties that we know are extremely common in the subprime market. It's an extra $100 million a year that African-Americans are paying for the privilege of borrowing while black.

I think we have two choices when confronted with that stark debt. We can try to explain it away by referencing a series of individual variables which as Marva suggested and Hattie suggested are often grounded in a history of racial discrimination, even a purportedly neutral value such as loan-to-value ratios. We know from Tom Shapiro's work how much African-Americans have to put down has to do with inherited family wealth. Whites are much more likely to have inherited family wealth that they can use to pay down an initial down payment than African-Americans are. African-Americans are also much less likely to have acquired significant equity in family homes due to histories of redlining and de jure segregation.

I don't think that ultimately explaining away the racial disparity does any of us any favors. I think instead what we need to look at is how do we close that asset gap. If we choose to explain away this disparity, my concern is that ten years from now we're going to be asking ourselves or trying to explain away why African-Americans are another $1 billion poorer in assets than white/non-Hispanic Americans in the aggregate. At this moment, we can try to look at what we can do to close that gap so that African-Americans are not losing from their communities $100 million a year or we can ignore it and let the asset disparity continue to mount. Thank you.

MEMBER SEEBACH: Can I just take the liberty of just saying that I certainly appreciate the statement but as an institution I first has to look to my own house. I have to make sure that my policies and my controls are working effectively and then I can engage in the larger debate on how to correct that problem. I think each institution here would feel the same way.

MEMBER THOMPSON: I think it's absolutely true that we must all of us work on both of those levels all the time and that we must as individual institutions and organizations strive to make sure that our policies are raised neutral. But as a policymaking board which the Fed is and as all of us collectively working on this issue, we will not address it if we simply look at the individual pieces of it. We will leave in place the systemic inequality which will perpetuate itself.

MEMBER SEEBACH: Forrest and then Stella.

MEMBER STANLEY: Just following up on what I think Mary Jane said is the new data is an excellent tool for banks to use in self-critical analysis and also for community groups to look over our shoulders and peel away some of the layers of the onion as well as regulators. But I think as lenders we would be remiss if we fall in love with the new data and don't do some of the traditional analysis that we do to check for fair lending and that being regression analysis, that being matched pair testing, mystery shopping.

I'm a little bit afraid that we're falling in love with the new numbers and forgetting about some of the more traditional things that we do to try to make certain that we're not discriminating. I just remind that those tools are also available and they help fill in some of the gaps that the current HMDA data still has.

MEMBER SEEBACH: Thank you. Stella.

MEMBER ADAMS: Thank you, and thank you, Forrest, because that was one of the things that I wanted to point out that this new data is just an additional tool that community groups now have and that fair lending experts still have. But I want to address what Diane said because the duty is both. As a Fed policy board, there is larger economic policy that encouraged and created the disparity gaps that exist historically between the African-American community and the white community that these policies of credit rationing based on distinguishable characteristics of borrowers that are prize winning theories were put into place by banks in this country over time that have created the separate distinct marketplaces that African-Americans find themselves in.

The credit that my mother had was finance company credit because she couldn't go into your bank to get money. But finance company credit even though paid on time is treated less favorably in credit-scoring models than bank credit. A J.C. Penney credit card is treated less favorably and most women and minorities have department store credit cards, not VISAs and MasterCards. It's treated less favorably in these models. So neutral policies that may have some rationale that have disparate effects, you have to look at.

Is there a way to reach your goal as an institution and our goal as policy-makers that has a less deleterious effect on African-Americans communities, on communities of color in this country? We cannot continue to have two separate and distinct credit markets in this country and this data shows us in a way that we can only speculate about before this data became available just how separate and distinct those markets are.

We all have duties in-house especially when you're one of the largest lenders in the country. Your in-house analysis has market-wide possibilities. So it's not sufficient for you to just say I looked at my data and we looked fine and yet you still have disparities within your dataset. You have to say how can I close that gap. How can I address that? That is what is required under the Disparity Impact Theory of Discrimination that even if it is neutrally implied but it has the disparate effect even if you have a business necessity for why you did, if there's a less discriminatory alternative, you must use that alternative and we're not thinking enough outside of the box about what those alternatives are.

There are policy ways that we can make it work by looking at this and saying in the service test if you decide that credit scores are the issue and credit quality of the borrowers is an issue, then what are you doing in terms of the service test to increase financial literacy, to work with community groups, to work with these minority communities to improve their credit if that turns out to be one of the factors?

If the issue is loan-to-value, then what are we doing to encourage savings in this country as financial institutions? Americans are negative savers. What are we doing? Are we doing financial literacy in college? I know when my daughter stepped on a college campus the first thing she was greeted with was a credit card, had not one job the first. So we're already putting our children at risk before they even get out of high school. These are the kinds of policies that you have to look at in terms of how is it going to impact their ability to buy a home later on.

MEMBER SEEBACH: Sheila.

MEMBER CANAVAN: Yes. With regard to victims of predatory lending, it's quite well known by now that the typical victim is an elderly person of color and the work that we have been doing so far at the Fed does not include an analysis of the impact on the elderly. I would urge the Fed to include the information that they have available to them in the Georgetown database which does capture the information on the age of the borrowers in the analysis of the HMDA data. Doing so will allow the Fed to assess the fairness of the lending the process and the activities of individual lenders with regard to our elderly population which is victimized most often by predatory lending practices.

MEMBER SEEBACH: Thanks. Dan.

MEMBER DIXON: I was just going to say there's a big intersection in a lot of the discussion now, not so much the subject between some of the topics we're talking about here

versus topics we're going to get to later in today's agenda both in terms of alternative mortgages and Katrina for that matter. Somewhere I would be interested in getting some additional views just on one specific area, the question of whether borrowers have adequate down payments to justify home loans.

From our experience the amount of equity a borrower has in property is a very strong indicator of their credit capacity and yet we acknowledge that there are large segments of the population that lack the typical 20 percent down. That's clear and there are a lot of reasons for that. But it's just a fact at the moment.

So the question is how do we close that gap. Indeed, there certainly have been a lot of initiatives aimed at getting loans to consumers who don't have a typical 20 percent equity position to buy a house through various government programs or silent seconds at the local level, etc.

But then in other circumstances, those are the no-down-payment type of products that end up being criticized in another context and certainly in New Orleans, we're going to have all kinds of consumers who are going to be faced with the challenge of how they get back into home ownership situation when most if not all of their assets have disappeared through flood waters. So that's a tradeoff that needs some additional investigation and discussion.

MEMBER SEEBACH: Thanks Dan. Hattie.

MEMBER DORSEY: I want to go back to Diane's recommendation with reference to the policy and support that. From Atlanta, I know that we had the color of money and the whole issue of redlining and whole neighborhoods being bypassed and the fury of the banking community to begin to try and correct what was an obvious wrong, the wrong being redlining. As I think about what's happening today, I ask myself to question is this a new form of redlining, a new form of redlining based on again the color of one's skin but now being a little bit more subtle or maybe more overtly subtle around the issue of income and pricing based on the local, based on job as I said before.

What I would like to see us to do so that as we evaluate and the banks evaluate it is that don't leave it up to an individual bank or individual community. Let's have the public policy as the Feds can do something about it to do something about it with controls of some sort that says that you shall offer the same product on one side of town that you offer on the other, that you shall not make an evaluation based on the job that one has but you based it on credit scores if that is the

guiding principle of making the loan. I think we have to have standards and those standards have to be fixed and they have to be applicable to all groups based on their qualifications for a loan.

MEMBER SEEBACH: Clint and then Dennis.

MEMBER WALKER: Thank you. I would like to respond briefly to what Diane said also. I think it's absolutely imperative that we peel the onion on this issue and don't just look at the big picture view but you find out all the elements of why there is a disparity. I think the Fed is turning to the point where one of the main reasons for that is credit scores and we've heard a lot today about that credit score that it might be inherently discriminatory in that disparate impact. At the time, the banks have the obligation to make safe and sound loans and credit scores are empirically derived to statistically predict risk.

It is in everybody's best interest to examine if that's the reason. Is it like Stella said? Are there less discriminatory alternatives predictive of risk? If there are, then basically they can expand their pool of who they can make credit available to them and it's in everybody's best interest to do it. But I think in order to really come to a conclusion that works, you really have to get down to all the various individual elements so that then you can devise policy alternatives that will make credit available to a wider spectrum.

MEMBER SEEBACH: Thanks, Clint. Dennis.

MEMBER ALGIERE: I don't disagree with any comments being made here but ultimately the regulator is the one that's going to be coming into your institution and determine whether or not there's any redlining or any type of discriminatory practices. We did hear yesterday that as a result of the initial review of the data a number of banks have been referred to not only HUD and Department of Justice but also to other federal regulatory bodies. It was also mentioned that they're going to look deeper. The Fed at least is looking deeper and the regulatory bodies look into a little bit more why this is happening.

I would be interested in seeing the results of at least a preliminary review of the data and also the status of these reviews by not only HUD and DOJ but also FDIC, OCC and OTS. Am I correct in that that they have referred those institutions to the regulatory bodies?

MEMBER SEEBACH: That's right.

MEMBER ALGIERE: Out of the 8,800 they reviewed, I forgot what the percentage was.

MEMBER SEEBACH: Two percent.

MEMBER ALGIERE: Now out of that two percent, 50 percent were non banks. They were mortgage companies and it's my understanding they were referred to HUD, Department of Justice and FTC.

MEMBER SEEBACH: That's right.

MEMBER ALGIERE: So I would be interested to see what the feedback is from those onsite and offsite to further examination.

MEMBER SEEBACH: That will be a very interesting issue because those departments aren't usually in the business of going in and doing examinations. So it will be interesting to see how they move forward with the data. Diane.

MEMBER THOMPSON: I think my point about the big picture is not that we stop there, but that we also don't stop with the details that what the big picture tells us is that what we have been doing so far to try to address issues of fair lending and asset building is not working and that we need as Stella says to think outside the box to develop new models that will allow us collectively to close the gap.

One piece of the Fed analysis that we haven't talked about is the Fed's staff in their article say that much of the disparity can be explained away by the lender. Now what this means is that African-Americans are ending up at subprime lenders a lot more than white lenders are and as Glen Canner suggested yesterday, one of the possibilities that this suggests is that there's a whole lot of steering going on in the market.

I was disappointed that the Fed staff in an attempt to try to drill down to some of these details we've been talking about used a private database that is not generally available to other researchers to drill down in and in drilling down, they only looked at subprime borrowers. They didn't do a comparison to prime borrowers in that database. So they missed the opportunity at that point to give us more information about the extent of steering whether or not we're seeing people with the same credit scores getting prime loans and subprime loans.

As we know, somewhere in the order of 15 to 30 percent of all prime borrowers as suggested by Peter Zorn's work are in fact prime borrowers. So there is undoubtedly some steering going on which in some sense almost begs the question of how important the credit scores are. Until we've gotten rid of the steering, until we understand truly the extent of the steering, we are not going to be able to understand exactly how important those credit scores really are.

On that note, I would hope that the Fed would use its influence at CRCE to get a

broader look at that data and to have that data made more widely available in some form to other researchers so that other people can pull the data apart, look at it, put it back together to try to understand what it means from a variety of perspectives.

MEMBER SEEBACH: I think one of the things that will be most useful is when the Fed does complete its study on the credit reporting, credit scoring, that won't be limited to mortgages but I think it's due out next year and I think that will be very interesting to this debate. Stella.

MEMBER ADAMS: I want to point out a couple of other things that I thought were very interesting and encourage further research on and encourage further thought from a policy perspective on in terms of regulation. One of the things that came out of this study that I thought was interesting that disparities were smaller where there were more eyes looking. The disparities were smaller within CRA assessment areas than outside of assessment areas. The disparity was smaller between financial institutions and broker correspondent lending.

So the concern I have is one of the things that we have is we have regulated institutions and we have institutions that are regularly examined, that they are regularly reviewed and you see the disparities going in the smaller direction and then you have the unregulated affiliates and the independent mortgage companies that are a greater and greater part of this market that don't have that same scrutiny, that same regular review and we see in the data a distinct difference between where eyes are looking and where they are not. We also see that within assessment areas that where CRA is again making a difference because in that the disparities were small.

The other thing that Hattie mentioned that triggered something for me is the role overages play in this and really drilling down to see when you give discretion to too many people in the food chain it allows for subtle differences in view point, but they don't have subtle results. I was tempted to bring today but I don't have to because we've all seen the photos. So I'm just going to describe them.

Out of Katrina there were two photos, one of an African-American man trudging through water with milk and bread and he was called a looter. The other photo was of a white woman trudging through water with milk and bread and she was said to be finding provisions. The vision is stark but it goes into overages is am I seen as a risk or not. Does that individual loan officer see me as a risk as opposed to [inaudible]. While we both walk in asking for the same thing, we may be on the margin but one is seen as a risk and one is seen as not a risk and because of that perception

our treatment is different and it leads to these kind of stark disparities that when you go and look and drill down too deeply into the detail, you will lose the forest for the trees. So those are some of the other things I thought were really interesting.

The other one I thought was really interesting was around prepayment penalties and the length of them and that if you paid on time for eighteen months, your credit score would improve enough for you to qualify for a prime loan and yet most prepayment penalties are in the two to three year range locking people into subprime credit who would otherwise qualify for prime.

MEMBER SEEBACH: Thanks, Stella. Marva.

MEMBER WILLIAMS: You know I've been sort of sitting here reflecting on this issue and I think one of the challenges that we have is there are so many people who are not engaged in the financial mainstream and the issue of the unbanked and the incidence of higher cost mortgages I think those are connection. But it goes beyond the mortgage market. It also applies to other areas of financial services. Why is it that immigrants and lower income people are outside of the financial mainstream and what is that relationship?

One of the reasons that my bank offers me free checking and free savings is that they figure once I'm a bank customer that they can sell me other kinds of products. Many of those products are asset development products. They are certificates of deposits. They are lines of credit, home mortgages, other kinds of products that help me to build assets for my family.

When people are locked outside of the financial mainstream, they do not have access to those financial products and they do not have the comfort and trust that I've developed with my financial institution and so may self select other kinds of lenders and other kinds of lenders are doing the market and the outreach in these communities to appeal to these customers. I think that it really is important for mainstream financial institutions to do the same thing because there are market opportunities here.

The second thing I wanted to bring up is that we've talked a little bit about some of the household impacts of predatory home mortgage lending and Diane talked about housing appreciation. We did a study about a year ago that looked at the relationship between high cost lending, increased foreclosures, vacant dwelling units and housing depreciation and these are very serious societal issues and patterns that impact all of us. So this is not just an issue for lower income people but really it is a community of metropolitan. It is industry wide issue that really needs to be addressed.

MEMBER SEEBACH: Thank you, Marva. Mark.

CHAIR PINSKY: This is a terrific conversation and it strikes me. I'm not a data person. I'm not a quantitative person. So I had a hard time digesting all of the data and part of it, Diane, thank you for lifting the thought out of that a little bit for me at least. But I think this is an issue that we all know that there's more there than meets in the eye in some way and it's very easy and reasonable to really dig into the data and get our finger nails dirty and try and figure that out and we need to do that and for reasons I'll say.

But there are just a few observations as I listen to this. Diane, you ran the numbers. I don't know. I can't imagine that it's only $100 million in that effect. You may have just been very conservative about it. I just wonder about that. It would be really interesting, I would be interested, in going back and really figuring that out.

But also as we listen to, as Dan pointed out, having net worth helps you build worth. It's a good thing. So the snowball effect of that obviously which you pointed to is really quite significant about this. This all leads to one point.

Then the credit scoring issue is one I'm really interested in. I think some of us here are familiar with the work that Self Help has done with their home mortgage program and one of the things that they really found out about credit scoring was that if you took out knocks on credit history that had to do with medical expenses which often were because people had to go to emergency services and because they couldn't afford them and then they get into a billing situation in which they're trying to work their way out of if you take them out and then you lend according to that that you actually perform as well or better than more traditional prime markets in some ways.

There are some really interesting issues around that that aren't obvious and I think we do need to get inside that. I know that there are some folks starting to think about it. So just as I listen to this and as someone's going to be leaving the CAC but not leaving this issue, I just encourage. I hope that the CAC will continue, I know the FED will, to really keep digging at some of these issues, some of the beta issues in particular because I think we need to broaden how we think about this and really understand the ramifications on a whole range of issues going forward. So it's very rich I think, a rich area to understand.

MEMBER SEEBACH: Thank you, Mark. Kurt.

MEMBER EGGERT: One of the challenges of this data is lending industry argues that their pricing is risk based. But the problem is if you look at the subprime market, that

argument falls down a little bit. We've seen the studies that Diane cited that 20 percent to 30 percent of subprime borrowers could have gotten prime loans. Of the remaining subprime borrowers, we don't know if the price they got is that well risk-based.

I think the problem is it's very difficult for borrowers in the subprime market to shop effectively based on price. If you're a prime borrower, it's easy to look in the newspaper and say what are rates today and you can go out and you can get that rate. If you're a subprime borrower, it's difficult to do, to figure out exactly what the best price for you should have been.

I think the great challenge that we see is how do we make the subprime market more efficient. How do we make it so that people can shop based on price more effectively so that lenders have to offer a good price to someone given their risk characteristics because that how you would get the borrowers. Right now, lenders compete based more on who can get to the borrowers first and lock them in rather than who can offer the best product at the best price for subprime borrowers.

So when we're looking at this HMDA data, I think one of the things we should ask is what steps can the industry and the regulators make to shift it so it is truly risk based pricing and isn't pricing based on what you can get people to pay rather than what their risk characteristics should justify.

MEMBER SEEBACH: Thank you.

MEMBER DORSEY: Mary Jane, could you ask Paul, I'll put Paul on the spot, to talk about credit scores and the aggregation of credit scores from various credit reporting agencies? But when you're applying a mortgage that aggregation comes into play and the fact that maybe Equifax says your score is 750 but the combined scores drop it down to 720 or etc. and how in fact does the consumer work with that?

MEMBER SPRINGMAN: Thanks. First of all, there are no aggregate scores that I know of. The score most often used is a Fair Issac score that is roughly the same algorithm at Equifax, Experian and Trans Union.

There are differences in the score, however. If you were scored on each of those three, there would be a difference and the differences there are due to two reasons. One, they're all built at different times with different data samples. So the algorithm is not really adjusted to try and generate the same score and the second is we all have different data within our databases. So the data that drives the algorithm is different. So naturally, you will have a different score at each one.

Now some of the things we've talked about I'm not aware, Stella, that a finance company paying a good credit on a finance company has less value than paying the good credit of a bank. I've never heard that. I made a note to check it but I've never heard that kind of thing.

MEMBER ADAMS: Check it out.

MEMBER SPRINGMAN: And we've talked about making payments on a mortgage over X number of months. A credit score is derived on all the credits that you have. You could pay the mortgage well. But if you're not paying your credit cards, that's going to affect your score and how we work with the credit grantors in using the score, the mortgage is probably one of the more complex decisions that you would have to make.

A score is just one element in how you're going to make that loan decision. So it's do have a job. How long have you been in the market? So there is other stability and predictive elements that an institution would use other than just a credit score. So as we do our analysis from the data and look at scores and how it impacts different groups, we just have to keep that in mind.

MEMBER DORSEY: I would say that check out another maybe one of the institutions because I'm in the process of building a new home and they aggregated my scores.

MEMBER SPRINGMAN: They could have average them.

MEMBER DORSEY: Averaged them, yes.

MEMBER SPRINGMAN: But it's not an algorithm that takes the data from all three to create a single score.

MEMBER DORSEY: But I go back again to the policy issue. If in fact a bank has the ability to combine them or to do whatever, then I can be up or down based on the reporting agency and I think there is a fairness issue and I feel like I pride myself on paying all my bills in a timely way because I hate late fees. But what does the consumer do and what kind of policy can help to guide what happens when you go out for the largest loan in your life?

MEMBER SPRINGMAN: If we would pull a sample of X thousands of consumers and do credit scores on each of the three bureaus, I'm just going to make a broad statement here, the goods would be good. You would have variations but you would not have someone who is a subprime at one bureau and then an excellent payer at the other. I don't know what the percent but you take CitiBank and GE and Wells Fargo and Bank of America, we all get that same credit data. The difference on our data is around the fringes of smaller lender that we try and get to really differentiate ourselves in each market.

I don't think because you pull three scores and you average them or however it's presented to you makes you good or bad. There's a difference but you should be in the same category of a good pay or an average pay or however they look at it. But technically there is a difference just by the way the whole system works.

MEMBER DORSEY: And I think that's the technical issue we have to address.

MEMBER SEEBACH: Thank you. Thank you, Hattie. Clint.

MEMBER WALKER: I'm just responding a little bit to the earlier point that Stella raised which I thought was very probative what you said that the disparities are different between CRA or designated areas outside CRA and some of the regulated institutions and non regulated institutions and one other thing I'd like to point out is that some examination has to also be done on thanking regulators supervisory staff because they frankly are discouraged from going outside the prime and super prime areas to near prime or subprime markets. The CRA wants you to do that and they want you to do that well.

But when you get beyond that, they require increasing reserves, increasing capital, increasing scrutiny from these kinds of loans which makes them much more costly to do and it creates a serious issue for regulated institutions who want to get involved in that market. So if something could be done to assist banks who want to get involved in that market by the regulatory supervisory staff, I think that would also help to a degree.

MEMBER SEEBACH: Stella and then ?-

MEMBER ADAMS: I think that helps. We still have to go back to Kurt's point to get the inefficiencies out of the market and one of the ways to do that is for the prime market to reach down and get those 20 to 30 percent prime borrowers out of the subprime market into the prime market. But if we do bring regulated institutions in the market, they have to I think bring their skills into the subprime market.

What I've seen when regulated institutions have dipped into the subprime market, they've just adopted the subprime culture that existed when they did that and that didn't bode well in terms of efficiencies. I think we have to determine what we want to the subprime market to be. Are we establishing [inaudible]. Its stated goal was to give a second chance to borrowers so that they could reestablish themselves into the prime market. What they've really become is just a separate and an equal credit market with massive inefficiencies that have deleterious effects on communities.

MEMBER SEEBACH: Dan.

MEMBER DIXON: I don't spend my time collecting and analyzing all the data. So other people are going to be more knowledgeable about some of these facts I suspect I'm sure. I understand that in the mortgage business something in the range of 70 percent of loans are originated via mortgage brokers either in a mortgage banking structure where there is funding or just the brokerage, pure brokerage, where it's delivered to a financial institution to actually fund it. And I think further, Stella, you mentioned if I understood your comment right that in looking at some of the HMDA data the brokers tended to have the lower disparity.

MEMBER ADAMS: Yes.

MEMBER DIXON: Okay. One of the concerns I've heard is that brokers tend to focus on a particular individual market and a different broker is serving a different market. So each of those brokers might have completely consistent pricing in that particular market that they're focused on but the brokers are significantly different pricing from this broker to that broker and then there may be overages associated with some of that production and not so much with the other. So I think there's a lot more research that may be appropriate.

MEMBER ADAMS: But if you're the lender and you're in that market and you buy from both brokers and the broker with the high costs is only serving the minority community and the one with the low cost is only serving this one, you are in violation of 805 of the Federal Fair Housing Act which says you cannot purchase discriminatory paper.

If you know that you are giving loans at different rates to different races, it doesn't matter how you got them. If you bought them, you bought the problem. So it's important for the lenders to make sure that the brokers they do business with understand fair lending laws and if they notice that a broker is charging more for African-Americans in African-American neighborhoods and he's charging an higher overage than the prevailing overages that are coming out of white communities, they have a duty. You have the duty to fix that.

You can't just say oh well. He's equally stripping wealth from black folks and this one is equally providing service to white folks and since they're both doing it equally, it's okay. It's not.

MEMBER SEEBACH: Governor Bies.

GOVERNOR BIES: I just wanted to follow up on the comment that Clint made and make sure that this committee is aware. We are in the process of all bank regulators looking at changing capital rules right now and we just issued an announcement of proposed rulemaking

around Basel I capital changes will apply to 8,000 institutions, the vast majority. And something will come out next year that will deal with the more sophisticated dozen or two banks that will deal with Basel II.

One of the things you'll see in the one that's out for comment now and the one that's coming out is we are trying to solicit input around looking at capital for different types of lending in slightly different ways and we're trying to look at things and things like FICO scores which are mentioned. CRA lending is mentioned and so you might also want to look at it from some of the issues that's being discussed around this table and even though it's called capital to the extent that it does affect what regulatory capital is held for different types of lending, it may influence some of the comments you're making. I just want to make sure that you're aware that the one is out for comment right now.

MEMBER SEEBACH: Thank you very much. Sheila.

MEMBER CANAVAN: Yes, I also wanted to say that I found that what Clint said interesting and very important and I'm glad to hear that I did some work in the south a year ago and I had not worked there before. I was in rural Mississippi and my clients were African-American and I learned that their mortgages were definitely part of their financial plan for their lives. They took out only ten or fifteen year mortgages in general because they knew they were going to be facing health issues down the line and they wanted to have their homes paid off. That was something I hadn't experienced before working in urban areas. People had thirty-year mortgages or whatever. So that was very interesting to me.

But the other thing that I learned and was most struck by was that my clients were being steered into loans by people who worked in chicken plants, by people who worked at the FHA and they were being steered to three different subprime lenders. So here on the one hand, people were trying their very best to do the planning responsibly for their lives and on the other hand for whatever reason, they didn't feel they had access to the financial markets in general and they were making this very important decision based on the advice of someone that they didn't know was probably being paid in one way or another who worked at the chicken plant. So these are tough issues to deal with but I think it's very important the work the Fed is doing.

MEMBER SEEBACH: Thank you, Sheila. Susan.

MEMBER BREDEHOFT: Perhaps the situation could somewhat be alleviated by the establishment of special purpose credit programs. And it's been a long time since I've looked

at this section of Regulation B but under Regulation B a bank can set up a special purpose credit program for minority borrowers but certain steps have to be taken in order to do this. The first step that needs to be taken is to establish a need.

As a banker in not my current life but in my past life, I had considered the possibility of setting up a special purpose credit program for minority borrowers but I didn't really know how to go about establishing a need. On top of that, you do have to track performance and results and things of that nature and you can only set up the credit program for a limited period of time.

So maybe through the analysis of this data, the regulators can assist banks in performing that initial analysis. Where is there a need? Which areas of the country are the most severe abuses occurring and establish certain MSAs or regions as eligible for special purpose credit programs and that would make a lot easier for banks to initiate such programs?

MEMBER SEEBACH: Thanks, Susan. I was going to open it up to the Governors to see if there were any questions you all have for the group.

VICE CHAIR FERGUSON: I would like to push a bit more on this issue of financial literacy which is an area that obviously the Fed is very interested in. I've heard many comments that some implicate the question of financial literacy, Sheila's point about individuals not feeling comfortable knowing where to go. I've heard a few I guess other comments.

Is there anything more to say about that? It strikes me that this is obviously a multifaceted issue that we're dealing with. I'm only thinking of one potential part, but is there anything more to talk about with respect to financial literacy and how we can help people understand what their choices are and their options?

MEMBER SEEBACH: Certainly. Let me start with Dennis.

MEMBER ALGIERE: I think Marva hit the nail on the head and it's something we should bring up perhaps in future discussions which is the unbanked, the unbanked going to the nonbanks, the question of the unbanked going to the nonbanked entity and really they're not getting the best deal. But it all comes down to how do we get the nonbank into a traditional bank.

I think financial literacy is a part of that and I think that should be a future discussion for this body. I think Marva brought that up and she did a good job with that. We had some discussion about that in our subcommittee and I think we should put some time aside in perhaps a future meeting, Mr. Chairman, that you won't be in attendance dealing with that very same

issue.

CHAIR PINSKY: I will. I'll be over there.

MEMBER ALGIERE: The unbanked and financial literacy and what banks can do and what they can offer to get the nonbank in.

MEMBER SEEBACH: Susan.

MEMBER BREDEHOFT: I think that for financial literacy it is the big issue. When you're looking for a house, you go to a real estate agent. If you don't have an attorney and if you don't have a bank, that real estate agent is going to steer you to lawyers and financial institutions that they have created alliances with. I don't know how widespread mortgage fraud is but I happen to be very closely aligned with a federal investigator, my husband, who has been investigating mortgage fraud and these arrangements that he has investigated are not always beneficial and have been harmful to many applicants and borrowers.

So I think financial literacy is important and people need to understand that there are alternatives. You can use your real estate agent for one aspect of a transaction but you don't need to use them for every aspect of your transaction.

MEMBER SEEBACH: Thanks, Susan. Stella.

MEMBER ADAMS: I think financial literacy is important. I think if most of the lenders in this room were to look they would see then a number of their minority customers are writing checks to mortgage companies every day and most people don't think to go to the institution where their checking and savings accounts are for their loan. That is something that is an internal marketing piece that banks can do to let your customers even your low wealth customers know about financial services that are available to them as your customer to encourage them to consider you for mortgage loans and to consider you for those asset building, not the asset stripping, but the asset building tools that you have.

The other thing is in terms of we need to put financial literacy in high schools, in elementary schools, in colleges, not having the first experience that an eighteen year old gets in high school is getting an invitation to a credit card but talking about savings. These kids come out of college with $20,000 and $30,000 worth of debt and they don't really understand how to manage that debt and they're starting out in a hole. These are our brightest and best and our future high income wage earners.

We have to also think outside the box in terms of employer's supported financial

literacy campaigns that teach basic savings and checking and the benefits of having basic services and basic accounts and participating in financial literacy programs not just having something up on a website. Most of these folks don't have access to web site programs. But getting into the community and really not attaching the literacy to account opening and how you balance a checkbook but attaching that to services is just critical.

Financial literacy can't be done in sitting and having a twelve module course for somebody to go through. They're not going to go through it. But to make practical and hands-on in a way that people can relate and understand. At the Community Reinvestment Association of North Carolina, they are embarking on a huge financial literacy program, I actually have a sample here, that is going to use television, Telenovella, to teach financial literacy and health issues to the Hispanic community. It's a way to blend in through this soap opera real life financial literacy tools in a way that folks are captured and in a way that's practical for their use.

So being more creative about how you do these kinds of things in terms of financial literacy is key. The way we're doing it now is way over the head of most folks and they just don't get it and it actually serves to scare them more and make it feel more complicated than it actually is.

MEMBER SEEBACH: Thanks, Stella. Lisa.

MEMBER SODEIKA: I work at HSBC. So I represent an organization that is in the nonprime market, the prime market and the wholesale industry and I remember a few years back an advocate friend of mine said, ? Lisa, let me tell you what I think about financial literacy. The best financial literacy a company can do is having the right business practices.?

And I am passionate about the importance of financial literacy. So I really had to sit back. He's right. I think you need both. I think you absolutely need both but it starts with on the lender's behalf a responsibility to do the right things. It has to start with the business practices and I think perhaps not wanting to turn this forum into a debate which was not its purpose. But I think it's important to talk about some of the things that lenders do because we've talked about a lot of studies and a lot of statistics and numbers have been thrown out.

But we've looked within our own organization and we do not have any practice policy and we audit against it to make sure there are not any possibilities for any steering to happen between from our prime to our non prime. In our non prime offices, we offer a prime product. By the way, most lenders do this these days. If a prime consumer walks into our branch or is solicited

by our branch, they get the product that they have coming to them in terms of their credit, their debt to income, their collateral, their LTV on the loan, etc.

We look at every single loan file. We have all types of measures in place to look at the loans we are purchasing when we have a broker or a correspondent business. We make loans that offer net tangible benefits. By the way, most lenders do that today. Most lenders in the non prime market do not offer incentives for their loan officers based on the profitability of the loan.

Now having said that to Diane's point, lots of changes taking place, lots of good things happening, but we still see the numbers we see today in HMDA and what's behind that. So the financial services companies including HSBC invest a lot of time, resources and money in financial literacy because we believe that while you have these best practices in place and you have to constantly look at what could be better the smart consumer is always going to be protected because they're going to know I know my FICO score. I shouldn't be in a non prime loan.

So we do a lot of education, Stella, to your point. We have a website, ?Your Money Counts? because a lot of people like to use the internet and they feel comfortable with it. But we also do workshops across the country with grassroots organizations. We also provide grants to organizations who do faith-based literacy because some people would rather go to their church on a Saturday and learn about financial literacy. So our goal is to find the right channel to find the consumers the way they want to be found, the way they want to be helped and maybe that's as simple as getting a brochure when they come into one of our branch offices. But that's a little bit.

One of the things this council could do is look at these best practices because everybody is doing something a little bit different whether it be on the business side practice side or whether it be in financial literacy and try to bring forth best practice models to the Fed that we would say is as a team collaboratively these are the things that seem to work. I think that would be a much more constructive step toward trying to understand and improve next year's and the years after HMDA results.

MEMBER SEEBACH: Thank you, Lisa.

CHAIR PINSKY: Mary Jane, just a time check here for a few minutes. I want to make sure that Vice Chair Ferguson gets his question answered.

MEMBER SEEBACH: Yes.

CHAIR PINSKY: But I also think that there will an opportunity to pick this up next time. It clearly is an issue. Governor Olson, you mentioned it this morning, the financial

literacy, we'll be talking more about.

MEMBER SEEBACH: Do you want me to close up?

CHAIR PINSKY: No, let's go through a few more points.

MEMBER SEEBACH: I have eight folks who are already on my list.

CHAIR PINSKY: If they say one word, everything will be good.

MEMBER SEEBACH: I think we're good. If you can keep it down to three words, we're okay. Forrest.

MEMBER STANLEY: Yes, just in partial reply to the Governor's question, I think almost all responsible lenders have a very vibrant and aggressive financial literacy program. Quite honestly, it doesn't mean we can't do more. I mean the financial institutions do it. Community groups do it. The Fed does it. But quite honestly, it is a more systemic problem than just the financial institutions and we can't do it all.

As I said, I think the industry could probably do more and I think we should. But it's to the point about training needs to be in schools and colleges. That's not something I think the financial institutions community can address directly and obviously it is something though that everybody is looking closely at because I think we all agree that an educated consumer is the best person for protecting themselves against the unscrupulous lenders.

MEMBER SEEBACH: Thank you, Forrest. Hattie.

MEMBER DORSEY: Financial literacy I believe is really key and what I think we need to begin to look at a group similar to those that I work with are housing development groups that really begin to break down the financial literacy issues within their apartment communities often times that they manage. No slam to the banking community but their purpose is to prepare people to apply for a mortgage. Ours is to prepare you to manage your whole asset, your income at the beginning in order to get to the point that you want to buy a home at some point.

But the other end of it is keeping it, preparing you for the whole spectrum of financial management and the support base for that is minimal. Even though I agree with Stella that we need to begin in the schools. Barring that many folks have not had that opportunity, then we need to begin to look at another way to provide the financial literacy programs to perhaps groups that are often not thought of and that's the housing development corporations that are at work in the neighborhoods and who own property like apartment units.

MEMBER SEEBACH: Thank you, Hattie. Marva.

MEMBER WILLIAMS: I'll be quick. I agree with the speakers today who have spoken in favor of financial literacy. I think that it's also important as well as financial consulting, one-on-one consulting. But we take a three prong approach to this area because it's important not to put all the burden on consumers. So in addition to financial literacy training, we're also involved in the development of affordable alternatives for lower income and minority consumers including creative outreach and marketing strategies and then the third leg of our approach is policy development and regulations. There needs to be appropriate consumer protections and other kinds of regulations around these market issues.

MEMBER SEEBACH: Thank you, Marva. Diane.

MEMBER THOMPSON: I'll also be brief. I think that we do need more financial literacy education, creative things that reach people at the moments when they're ready to hear it, where they're ready to hear it. I think part of what we need in terms of financial literacy education is more outreach and marketing by prime lenders. I'm also shocked at my clients to see many of them are prime or near prime and they're not being courted by prime lenders and there's this huge profit being made off of them by subprime and I don't understand that market failure.

But as Marva said, I think it's important not to put all the burden on the consumer and we'll be talking later today about adjustable rate mortgages, interest only adjustable rate mortgages option ARMs which Governor Greenspan has referred to as exotic and which I think and which I think even looking at the disclosures, many of us found puzzling and difficult to understand. Given I've been told by many lenders that most of the people that work in the branch offices aren't even comfortably conversant with all the products on offer by that bank often.

So I don't think that it's reasonable to expect most consumers to have an equal information and understanding of the range of loan products available to them and the kinds of loans that they can get and which one is the best for them. I heard a speech that Bill Apgar gave several months ago and he was talking about his son who was getting a mortgage and he couldn't tell his son whether it was the best mortgage. He sent his son to a mortgage broker he knew and the mortgage broker got him a slightly better deal but even the mortgage broker couldn't say that the slightly better deal was the best deal. I simply don't think it's possible to provide consumers in this evolving complex marketplace with enough information that they can be left to themselves to negotiate all of the complexities.

MEMBER SEEBACH: Chuck, would you like the last word? All right. Thank

you everyone. It's been a robust discussion as always. I think it's quite clear that the data is very useful. It's a good tool for all of us to use but it only begins the discussion and we all have to be cognizant of the larger policy issues that are not addressed by the analysis of the data itself. Thank you.

CHAIR PINSKY: Thank you everyone. Thank you, Mary Jane. That was certainly a robust conversation. You're right about that. That was great. I am going to keep us moving. Anne Diedrick will introduce the next discussion on the Economic Growth and Regulatory Paperwork Reduction Act of 1996 and let's aim on trying to use a half an hour. I know you have some important stuff to talk about and we will just cut a little into our break if need be.

MEMBER DIEDRICK: Okay. Thank you Mark. I'm just going to set this conversation up by just doing some paraphrasing from a Fed memo that was given to us on EGRPRA. Over the last few years, the Federal Reserve, the FDIC and the OTS, have been reviewing laws and regulations to identify outdated, unnecessary and unduly burdensome requirements pursuant to EGRPRA which is the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The agencies categorize their regulations by type and in January 2004 published a notice in the *Federal Register* requesting public comments on ways the agencies can reduce burden in consumer protection lending-related rules consistent with the agency's statutory obligations.

There have been several Congressional hearings on regulatory relief. For those hearings the financial services industry in particular but the banking agencies and others as well have offered over 100 proposals for statutory revisions to banking laws. Most of these proposals have been incorporated into a matrix. Board staff has selected four proposals for the CAC's consideration that have been discussed recently at regional meetings among consumer and industry representatives and the banking agencies.

The proposals relate to exemptions from the Home Mortgage Disclosure Act, the right of recession under TILA, the Gramm-Leach-Bliley Act, privacy notices and prior consent to establish financial institution branches. The Consumer and Community Reinvestment Committee considered seven questions and Mark has given us a half an hour to have a conversation on this.

CHAIR PINSKY: You're such an efficient committee.

MEMBER DIEDRICK: Yes, we're such an efficient committee and one of the things we really drive for in our committee is consensus. So that said, the first two questions I will

read to you and they deal with HMDA. The first is should depository institutions continue to be exempt from HMDA based on their asset size or should a loan activity test replace the existing asset size test. The second question is alternatively should more depository institutions be exempted from HMDA by increasing the threshold under the existing asset size test. The committee recommends to the Board that no action be taken on these proposals. I will now ask if anybody on this council has any concerns with the recommendations of the committee.

Okay. Moving right along.

CHAIR PINSKY: You may be done in ten minutes, Anne.

MEMBER DIEDRICK: No, we have a couple. We're saving a few. The next set of questions that we discussed yesterday had to do with the rate of rescission and in this category there were three questions. The first question was should consumers be allowed to more freely waive the right of rescission. Should the right of rescission be eliminated when a consumer refinances an existing home secured loan with a new creditor to obtain a lower rate with no new money advanced? And should the right of rescission be eliminated for home secured lines of credit and if so, why?

And the Consumer and Community Reinvestment Committee recommends that the Board takes no action on these issues regarding the right of rescission and I ask this Council if anybody on this Council has any concerns regarding the recommendation of this committee. Forrest.

MEMBER STANLEY: I don't necessarily disagree with the consensus that was reached in your committee. I would just point out that I think it's the second most common complaint that we receive at my institution which revolves around the right of rescission, customers complaining that they want their money then and obviously having to explain to them that there's a three day cooling off period.

If the consumer groups don't think that they need to address that common complaint, I don't know that the financial institutions feel that strong about it. Although obviously we'd like to provide good service and that's obviously a friction point a lot of times. I just want to point that out that that is a very common customer complaint at financial institutions.

MEMBER DIEDRICK: Yes, we did have that conversation in our committee and the Consumer Advocates didn't feel strongly.

MEMBER ADAMS: What we felt was that when we get into the further

discussions around the option ARMs and all these other kinds of exotics that what we were wanting is a more informed borrower. In order to have that opportunity to be more informed and to have product choice, you need that three days rescission time. It's critical to give that opportunity a second look and we think it's too critical to give up.

MEMBER DIEDRICK: Bruce.

MEMBER MORGAN: And I would just like to make a comment that I agree with Forrest. It's the most common complaint that we have. Most borrowers when faced with that disclosure and with that forum can't understand why we can't give them the loan. There's no new money out. It's the second case that you talked about where they're lowering rate in turn or alternatively they're just wanted to refinance. They understand all of the rules, all of the regulations because they've been making payments for quite some time but they can't understand why they have to ?wait to get their money.?

I would recommend that you consider at some future time if you're not willing to give up the three day right of rescission at least give the consumer, the borrower, the option of opting in or opting out. If they feel they're well informed, let them sign a statement that they want to opt out of the three day right of rescission and move on with the funding of their loan because it does cost them. The cost to the consumer is very quantifiable. If they're in a high rate situation, they have to pay additional interest to lower their rate in turn.

MEMBER DIEDRICK: Thank you, Bruce. Kurt.

MEMBER EGGERT: I wasn't part of the committee, part of this conversation, but I do feel the need to weigh in. If we look at way people end up in subprime loans when they're prime borrowers or why people end up with bad subprime loans instead in better subprime loans, one of the major causes is high pressure tactics by people selling them the loan. The three day right of rescission is crucial in an effort to give people the ability to back out once they realize that they've signed a loan that they shouldn't have because they've been taken advantage of.

If you allow them to waive the right of rescission, you'll see by those high pressure tactics an almost universal waiver of the right of rescission in these really bad loans. So you defectively say there isn't a right to rescind bad loan. There's just a right to rescind better loans which I think would be a bad idea.

MEMBER DIEDRICK: Governor Bies.

GOVERNOR BIES: There's one question around this right of rescission that I

would like some input from you guys on because what I hear is we want to protect the consumer if they made a bad decision. But we're doing it at the closing table and going back to the earlier discussion making sure people understood what the nature is they were getting into sort of says are we doing what we're trying to do to protect the consumer at the right time. In other words, should we be thinking about doing something earlier when they walk in and say I'm thinking of a loan and do something then rather than at the closing table.

It's a timing difference that I think creates some of this tension and I don't know if you all talked at all about when this should happen as opposed to what should happen. But that would be helpful to me to understand it because I'm hearing different things. We've talked about this before and this has been something that as I think about it from a policy perspective I'm caught between conflicting objectives here, a large part around this timing issue.

MEMBER ADAMS: Anne, if I could address that. There was a sad story that you all wouldn't let me tell yesterday.

CHAIR PINSKY: There were a couple of those, Stella.

MEMBER ADAMS: And so I'm going to give you a situation, a real life client, that we have in our office right now. These are upper income African-Americans with a $400,000 home on the Gulf Coast. These are not my typical clients but this is the situation.

They were fairly good sophisticated borrowers. At least they thought they were. They were refinancing again with just to get a better rate. They want to refinance into a one loan and they had a first and a second. They get to the closing table and the terms changed and they were like well I'm not too sure about this but they went on and then they got a call the next day that said the payout on your second there's not enough money to pay off your second. We need you to ask the other lender to subordinate the second loan which they said no. The whole purpose of the refinance was to get one note.

And they went and attempted to rescind the loan. The reason they came to us is that there was some fraud involved with the attorney not getting the bank to subordinate the loan without the client's understanding and paying out funds which they were like we'll really glad to repay the funds and we want our loan back. They've been in a struggle forever but that's the kind of thing that can happen. Even with a refinance with no new money, they ended up in a situation that they wanted out within the three days because there were changes in the terms and once they thought about it they were not satisfied with those changes and the terms.

It is critically important to keep that option available for the person who comes in thinking they know on the front end. I have to tell you that what happened to them is typical of what happens to a lot of subprime borrowers. They're told one rate or one payment at the front end and that's what's in all of their things and then at the closing table, they get an explanation on why they didn't get that rate and it just came down overnight and they're pressured right then. They'd be pressured to go ahead and go with the loan and the right of rescission is absolutely critical.

MEMBER DIEDRICK: That's pretty much why the committee decided to do nothing here and, Governor Bies, I'm sorry. We did not have any conversation about the timing of whether this should all take place at the closing table or sometime sooner than that. But I think that's probably when the borrower is really focused on the transaction and the terms of the transaction.

MEMBER THOMPSON: If I could quickly address Governor Bies' question. I think that there are certainly things to be said for getting the disclosures in advance but it's still indicated there are two potential problems. One is that the disclosures have to be loan specific and they have to be absolutely locked in. So what we see with a lot of early disclosures is that they change and that it doesn't do you any good to gun one disclosure if it's changed at the time that you get to closing. So it has to be locked in.

The other reason that the right of rescission works and that usually people get their notices is the penalty is really quite high for a lender who doesn't comply with the right of rescission. And it is really a failsafe. The borrower can walk away without paying anything. The borrower can just get out.

So if you wanted to try to move it before the loan, you would have to make sure that there was a similar strong self-enforcing mechanism. It can't be something that has no private right of action or imposing significant costs on the borrower in order to exercise.

MEMBER DIEDRICK: Sheila.

MEMBER CANAVAN: With regard to the timing issued raised by Forrest and Bruce in terms of the consumers complaining about this, we often hear lenders talk about level playing field and in that sense, we have a level playing field. All lenders hear that complaint. It's not a competitive issue for the lenders and it's so important to the consumers I think that that's just something that lenders should put up with.

Of course, people want to get their money quickly but they don't want to get their money quickly at the price of being screwed which they often are because mortgage loans are not

just interest rate in turn. There's also a lot of fees that borrowers learn about for the first time at the closing table.

MEMBER DIEDRICK: Thank you, Sheila. I don't want to cut you off but we have actually the more controversial topics coming up. So if that's okay, can we move on to the next one? Thanks. I hate to do this to you but I'm going to have to read you quite a bit because the next question deals with privacy notices and in order to understand the question, you have to have read the staff's commentary on this.

Currently, the privacy provisions of the Gramm-Leach-Bliley require institutions to provide their customers with notices describing their privacy policies and practices both at the time of establishing the customer relationship and annually during the continuation of the customer relationship. If an institution changes its policies and practices in any way, it must provide its customers with a notice that sets out the revised policies and practices. In addition, these notices must afford the institution's customers the opportunity to direct the institution not to share their nonpublic personal information with nonaffiliated third parties also called opt out unless the information is shared in accordance with an exception to the opt out requirements.

The FCRA provides a similar opportunity to opt out with regard to the sharing of certain personal information such as information from a consumer report or from an application with an institution's affiliates. The notices under GLBA must include notices of this FCRA opt out opportunity. One of the regulatory relief proposals would eliminate the annual privacy notice requirement for those institutions that do not disclose personal information in a manner that would be subject to an opt out under either GLBA or FCRA.

A second proposal would (1) direct the relevant Federal agencies to develop by rulemaking a summary privacy notice and an easy standardized opt out form; (2) preempt state law so that the simple notice and opt out forms supercede state privacy notices and forms; and (3) replace the annual notice requirement with a requirement that an institution provide the summary notice when a customer relationship is established and whenever the institution's privacy policy changes materially.

The Board has not expressed its views on the first proposal. The staff however notes that it is unclear whether the proposal would result in a significant overall reduction in regulatory burden. In commenting on the second proposal, the Board stated that while complying with the state privacy laws may increase costs for financial institutions state privacy laws may

provide consumers additional disclosures and protections beyond those provided by GLDA and that accordingly Congress should carefully consider both the potential costs and benefits of proposals that would preempt state privacy laws.

The Board also stated that the provision mandating a Federal agency's rulemaking would significantly disrupt the interagency project to simplify notices that is already underway. For example, the three-month time frame included in the proposal could require the agencies to establish a simplified notice before the agencies have sufficient time to evaluate the results of the consumer testing now underway and before the agencies have the opportunity to solicit and review public comments on any proposed changes.

The discussion question is should the annual privacy notice requirements be eliminated with either conditions as in the first proposal or without as in the second proposal. This question engendered a robust discussion yesterday and we came close to a compromise and consensus but not quite there. So I'm going to open up the discussion by asking Dennis to start.

MEMBER ALGIERE: Right. I think after discussion, we had some very good discussion, some of us on the committee felt it would be a good idea to put forth a proposal that would eliminate the annual privacy notice. As was stated by Ann presently once you establish a customer relationship, a privacy disclosure has to be given to the customer and presently we have to send that out annually and any time a material change is made to the notice. But for those banks that do not share information, therefore they don't have to provide the opt out to the customer.

I feel that eliminating the annual notice would be something that we could discuss this morning. So for those banks that do not share information therefore do not have to provide opt out in understanding that there's no material change to the policy of the bank, that just eliminate the annual privacy notice and just go forward with just the initial disclosure. I'd open up that for discussion.

MEMBER DIEDRICK: Diane.

MEMBER THOMPSON: I think from the consumer standpoint our concerns about the annual privacy notice and maintaining it are twofold. One is that the Board as I understand it is in the process of an interagency review of the privacy notice is to simplify them. And it is hard for me to figure out how useful the privacy notices are or will be until we know what the simplified notice looks like. So I think a final decision about what makes sense and how you handle the regulatory burden is best deferred until after that review is completed.

The second thing is that if we can imagine a simplified privacy notice something like a Shumer Box that quickly conveys the relevant information I can see two reasons that consumers even in the situation Dennis described might still want to get it. One is it could be useful for shopping. Some people care a lot about how their privacy information is shared.

Some banks share information. Some don't. As a consumer, it might be nice to quickly know which of the people offering you a credit card are sharing your information and are not or which of your credit cards are or are not. It might make a decision. For some people, it might make the difference between keeping one credit card and moving to another.

The second issue is that it is unheard of for more reputable lenders to acquire less reputable lenders and in that situation if you were a savvy consumer, you might not want your information shared with a less reputable affiliate and the annual privacy notice, you can't opt out of information sharing with affiliates. But the annual privacy notice reminds you that your information is being shared with perhaps less reputable affiliate and gives you an opportunity to then say, “no this is really a problem and I want to take my business someplace else.”

MEMBER ALGIERE: Diane, I would be more than happy to throw it on the table and further put forth that if the bank does not share with affiliates and nonaffiliates.

MEMBER THOMPSON: I still think that probably you want to give me that information so that to remind me what a good job you're doing of protecting my privacy.

MEMBER DIEDRICK: Remember this is the Paperwork Reduction Act and that's what we're supposed to be thinking about, unnecessary paperwork.

MEMBER THOMPSON: Unnecessary where there's not some corresponding benefit. The goal is not simply to reduce paper for the sake of reducing paper.

MEMBER ALGIERE: Certainly I do recognize the importance of giving the information to the consumer to shop around. Most banks even make these policies available as pamphlets in their lobbies. However the initial disclosure, I think, satisfies your concern about the consumer to shop around. Not unlike any other disclosure we give out as an initial disclosure, the consumer certainly is capable of shopping around, keeping in mind there are no material changes. If there are changes to the policy under the existing rules that is now in the proposal to change, they must notify or send to the consumer within a reasonable amount of time those changes.

MEMBER DIEDRICK: Could I just ask Kelly to step in here? She's had her hand up the whole time.

MEMBER WALSH: Thank you. I think we should remove the obligation to have banks have to produce the annual statement. It results in duplication of information and effort and expense that we ultimately have to pass on to the customers of the banks. We absolutely should have to give the privacy notice at account opening and whenever there is a material change including when the list of affiliates changes. I think a simplified notice would be great. We don't have it yet. So meanwhile we should eliminate the requirement for the annual notice.

The FACT Act requires an additional privacy disclosure. The current GLBA FCRA privacy notice informs our customers whether or not we share information with third parties and offers them the opportunity to opt out and whether or not we share information affiliates and offers them the opportunity to opt out. One thing some consumer advocates have said is hold off on eliminating the annual privacy notice because the FACT Act once these rules are finalized will require banks to further offer customers the opportunity to opt out of affiliate sharing specifically for the purposes of marketing information from affiliates and I think that just adds complexity to the privacy notice that's not needed.

When those rules are finalized tell us what we should disclose to customers. That's exactly what we'll do. We'll do it by sticking a notice in that statement. We'll absolutely provide the opportunity to opt out of that information sharing for our customers. But there's no reason why we shouldn't be able to eliminate the annual requirement which is millions of dollars in printing tens of millions of additional statements that are completely unnecessary and still protect consumers' rights here.

MEMBER DIEDRICK: Bruce.

MEMBER MORGAN: I would like to point out as with a lot of the discussions we have about disclosures, let's don't forget the consumer. Most people that get the annual disclosure statement simply throw it away. They've had the disclosure up front at account opening. The consumer views it as an unnecessary piece of paper that we have to send them and they literally bring the envelope into the bank and say why are you sending this to me. Is there something changed here when it's the exact same notice. So it generates a customer service burden. It generates consumer confusion and I agree with Dennis. If there has been no change, then we only send out a new notice if there is a change.

MEMBER DIEDRICK: Elsie and then we'll come back. Elsie and then Carolyn.

MEMBER MEEKS: This is really pent-up frustration from not talking about

financial ed. But I just felt compelled to say, I'm a consumer advocate but let's get real here. I want to know as a consumer what the privacy policies are going into a loan and I want to know if that changes. I don't want all those notices being sent to me all the time. Just like Bruce said, we throw them out the door.

MEMBER DIEDRICK: Carolyn.

MEMBER CARTER: I would like to respond to Bruce's point by saying that I think consumers would make a whole lot more use of these if they were simplified. One of the proposals is to simplify the notices but there's already a rulemaking or an interagency effort under way to simplify the notices. If people could actually read those notices without their magnifying glasses on and if they could understand them once they saw the words, then they might not be asking you why are you sending this to me. They might read it. They might understand it. They might be glad to be it and that's our goal here. It is communicate the privacy policies to consumers.

I agree that the privacy notices now are not doing a very good job at that. But I don't think the answer is to eliminate them. The answer is to improve them. It's very clear what needs to be done to improve them. I'm not saying that the details of working out a simple notice are clear but it's clear that simplifying those notices, making them user friendly, is the route to go here and that's what I encourage the committee and the Fed to focus on.

MEMBER DIEDRICK: Thank you, Carolyn. Faith.

MEMBER ANDERSON: A lot of credit unions don't have affiliates or don't offer the opt out because they don't share the information except under the exceptions under the privacy and giving the initial privacy notice is to us sufficient because even though we do it every year, nothing has changed and I think it does confuse members because they don't know why they're receiving it again and like a lot of the other financial institutions here our privacy notices are posted up on our web sites. If they have any questions, we always make sure we can answer them. We do give annual training to staff. So I think it is a cost burden to smaller financial institutions to have to create the privacy notice and it really doesn't change. What we try to do to make it more helpful is we also have added in there how to get their names off mailing lists if they don't that or how to get off the phone call lists and I think it would be very helpful to smaller financial institutions and even larger ones not to give the annual privacy notice unless there is a major change.

MEMBER DORSEY: I was just going to add yesterday I made the recommendation. This may be follows some of the policies and practices of the insurance

companies. Often times you get a notice that your policy has changed or they've made X, Y, Z amendment. It's very simple. You can turn to that particular page. You can look at what's happening and make a decision whether or not you're going to call your broker to complain or to respond. So it's about making it consumer friendly and easy to read and digest. Most often most of us throw it away.

MEMBER DIEDRICK: Right. I do think there is an overload of communications and that people don't take the really important communications seriously because they don't know which one is important and which is just another notification of something they were previously notified of maybe ten or fifteen times. We're going to move on to the last one.

CHAIR PINSKY: Anne, let me just take the sense of would people be all right. This is another important issue that you spent some time on yesterday. I don't want to short it but we are tight for time. Would people be all right if we agree we're going to cut short a little bit the discussion on nontraditional mortgage loans? I know it's an important issue. No?

MEMBER CARTER: I think the last issue is one on which the group reached consensus.

CHAIR PINSKY: Okay.

MEMBER CARTER: So you may just have a sentence or two.

CHAIR PINSKY: All right. Never mind.

MEMBER DIEDRICK: Okay. The last issue has to do with getting approval from the Federal agencies when a bank wants to establish a branch. So currently depository institutions are required to apply to appropriate a Federal regulatory agency to obtain approval to establish a branch and in addition, the institution must publish notice in a newspaper of general circulation providing the public with an opportunity to comment on the application. That's the only part of the commentary I'm going to read.

The question before us was should institutions meeting certain criteria, and those criteria were well-managed, well-capitalized, and with a CRA rating of at least satisfactory, be permitted to open branches without the prior approval of their Federal regulator. The committee recommends that the branch approval process be kept in place but be significantly streamlined to include both the local publication prior to opening a new branch and a very abbreviated request for approval to open the branch if the bank meets all of the criteria I cited. Is there anybody on this Council who has concerns about the recommendation that this committee is making?

MEMBER ADAMS: I think I just want to clarify that we wanted to keep the CRA comment period available. We wanted to simplify the application process to make sure that the information that is useful to community groups and banks that's used by communities is available but to reduce the paperwork burden on the banks in terms, I think the application may be something like fifty pages or something like that, to reduce the paperwork burden but to continue to allow for CRA comment and for the publication. But we did believe the application could be simplified and there could be some significant paperwork reduction without reducing public comment and without reducing oversight by the Federal group.

MEMBER DIEDRICK: Diane and then Elsie.

MEMBER THOMPSON: Just a question to clarify. I probably wasn't listening closely enough. So your proposal would still have the application notice posted on the web site so that consumer groups would have one place that they could go to check.

MEMBER DIEDRICK: That's correct.

MEMBER ALGIERE: The only thing that would change is if the bank meets those requirements, the well-capitalized, well-managed and the CRA rating, that we encourage the regulators to just streamline the application. That's all. The notice, everything else, would remain the same.

MEMBER DIEDRICK: What the committee really talked about was the fact that if you have all that criteria, the only thing you really are doing is notifying and asking approval from and frankly, we think it could be like almost a one-pager. Anybody else? See we did well.

CHAIR PINSKY: Wow.

MEMBER DIEDRICK: Just to sum up, it would be too long to sum this all up. So I'm going to turn it back to Mark.

CHAIR PINSKY: And I'm going to keep us moving. Thanks. It's clear as a lame-duck chairman that I've lost control of the committee. I hope that the chairman across the street doesn't have the same problem going forward. We are going to take a ten minute break and come back at 11:05 a.m. on these clocks, roughly a ten minute break and come back at 11:05 a.m. and spend a full hour, Carolyn, guaranteed if we need it assuming we do on non traditional mortgage products.

I also want to mention. I forgot to mention earlier in the agenda that Lori Swanson is going to do a presentation on the role of state attorneys general in the financial services

industry as a member forum. Off the record.

(Whereupon, the foregoing matter went off the record at 10:54 a.m. and went back on the record at 11:06 a.m.)

CHAIR PINSKY: On the record. We are going to focus for the next hour on nontraditional or exotic, I hear they're called, mortgage products. Dan Dixon is going to heat this up for us and I'm sure we'll have a good conversation.

MEMBER DIXON: Thank you, Mark. This was actually a topic yesterday in two of the committees and I will try and help facilitate a discussion to represent the issues that were covered in both the morning and the afternoon sessions.

If Chairman Greenspan is concerned about exotic mortgages, Consumer Advisory Council is concerned about it, although he's been quoted with regard to adjustable rate mortgages on more than one occasion. Some of you may have forgotten that a couple years he suggested that most consumers would have been better off if they had taken an adjustable rate mortgage as compared to a fixed rate. He later clarified those comments. I'll concede.

Non-fixed rate mortgages have been around for decades. Graduated payment loans for example and primitive, if you will, versions of adjustable rate mortgages were very common certainly in the last super-high interest rate cycle in the `70s and that's not to suggest that some of those more primitive products turned out to be very effective. But the concept of adjustable rate mortgages is certainly not a brand new development in this country.

The negative amortization ARMs just to set the stage have been offered by particularly west coast lenders since the early `80s when the rules for adjustable rate mortgages were finally developed to allow what we believe that at my company are consumer friendly but inappropriate mortgages. We have almost 30 years of experience in offering adjustable rate mortgages that allow for negative amortization that have optional payment features for consumers.

We've originated literally hundreds of billions of dollars of these loans and our experience has been superior. We have, at that volume, never had a case in which a customer was unable to make their payments because of that inherent structure of the product.

Now it's certainly the case that there are many different versions of adjustable-rate mortgages. There are different features. They are complex products. They do require a lot of training and education not only for consumers but frankly for lenders and other professionals in the real estate finance business.

It's also true that predatory lending has a long history in this country and elsewhere and is not just associated of course with adjustable rate mortgages. Now I think that there are plenty of examples in which predatory lenders were using loan products that had adjusting features and have been doing that for many years.

The current issue is I believe that there is a substantial growth in the offering of some alternatives products sometimes referred to as exotic products, sometimes referred to as affordability products and that some of these products are being offered certainly on the face of it in appropriate ways. That raises questions regarding on the one hand whether those originating the products are doing so responsibly in terms of their own risk management and their own credit analysis and the safety and soundness of the lending institutions are however it would be structured the investor who are investing in some of these products, secondarily, whether these products are being offered to consumers in a responsible way and there are multiple aspects of that question. Are the mortgages being disclosed effectively and are they indeed suitable which obviously is going to allude back to the question of consumer education, financial literacy and so forth?

So I think that there are a number of questions that have been teed up for our discussion today. I've highlighted a couple of those but let me try and get all of them on the table. I think it's very difficult to tackle these questions just in an isolated way. So I want to have the discussion be open to cover all of them.

The question is are some of the new loans unsafe and unsound as a risk management or a credit offering question. And frankly, I think that goes to whether or not the loans are being held on the portfolios of the originating lenders or even when they are put into securities forum, are the investors in all the tranches including the toxic tranches at the end of the list fully informed and appropriately managing those risks?

Secondly, are some of these new loans unsuited for some consumers? That goes to the introductory rates that are being offered. It goes to the combination of what's the introductory term versus the prepayment provision that may be applicable to that loan and/or is there a balloon, an all due and payment situation?

One of the questions that's been raised is what is the typical borrower profile and I think various of the members of the Council will have some input on that question.

As I say, are the loans being disclosed appropriately?

To the safety and soundness question, how much in the case of loan which allow

for deferred interest negative amortization what's the experience, how much data do we have to date on the inclination of consumers to take advantage of those options, how much of that interest is being deferred? We can have some comments on that.

A question that's obviously to be raised is what's the effect, if any, of these new products on default rates and foreclosure rates, what the correlation.

And finally, what is the impact or what is the effect of the developments of these new products in the marketplace on availability or affordability of home ownership? Obviously, these product are characterized by low, maybe too low, initial rates. But one of the arguments there is that that makes home ownership in some cases more affordable for consumers who otherwise might not have an opportunity for home ownership.

So with that background introduction, the floor is open for discussion. Diane, would you like to start?

MEMBER THOMPSON: Sure, Dan. Most of the low income consumers that I represent now have adjustable rate mortgages and these are typically adjustable rate mortgages with teaser rates typically at about twelve percent. That's the teaser. Fully index they typically go up to about fifteen or sixteen percent and with a ceiling typically of anywhere between eighteen and twenty percent.

The other really problematic feature with these is that the initial teaser rate is also the floor. So what we're looking at the fully indexed rate in comparatively low interest rate environment is above that teaser rate, is above that floor. So what you can expect is these mortgages are springing adjustable rate mortgages. They're only going to go up. These mortgages are often made to families on fixed incomes, people whose main source of income is receipt of supplemental security income received on account of their disabilities, some seniors who are receiving Social Security and living essentially on Social Security and some low wage workers. Those of the kinds of adjustable rate mortgages that I'm seeing.

The full risks of what is going to happen, what could happen, what the interest rate risk that those people are bearing is never ever disclosed to them. I'd like to share with you something from a prospectus issued in 2001. This lender in informing the bond purchasers of the risk in the pool said the following: ?Risk associated with hybrid loans credit impaired borrowers with loans that have an initial fixed rate term followed by an adjustable rate term may encounter financial difficulties as a result of increases in the interest rate over the life of the loan.

Substantially, all of the hybrid loans include a teaser rate. As a result, borrowers will face interest rate increases on their adjustable rate even in a stable interest environment. Hybrid loans with an initial adjustment date two or three years after funding are underwritten at the teaser rates. Higher risk of delinquency may result when borrowers who may qualify for hybrid loans with a teaser rate at the time of funding may not be able to afford the monthly payments when the payment amount increases.?

Now there are two things that I think are really significant about that. The first is that the lender is very aware of what the risks are, has disclosed these fully to bond purchasers but has not attempted to do what I would consider an elementary safety and soundness analysis, has not looked at underwriting the loans even at a fully indexed rate let alone at what's going to happen at the maximum rate. And what this implicitly acknowledges is that many of these borrowers two to three years into their loan are going to default.

The second piece of this that is really troubling to me is this is far more disclosure of the risks inherent in these loans than any of the borrowers get. I suggest to you that the comparative risk that a working family faces when their home is on the line is of much greater importance to that family and may even be of much greater financial importance to that family than it is the bond purchasers. Now this kind of disclosure is required by the SEC to people purchasing bonds but we are not currently requiring this level of disclosure to individual borrowers.

Several years ago, Elizabeth Renuard proposed and submitted a change to the adjustable rate disclosures and the main change that she proposed and what I think is the most important is to simply include a line on the TILA disclosure or with a box where it says what your APR is and what the payment schedule is that says this is an adjustable rate mortgage. This is the most that your payment could get to be.

Most consumers manage their budgets with an understanding of how much their monthly payment is going to be. It may not be the only thing they focus on. Many people are getting sophisticated about rates but it's a way that they have of understanding. They need to know is this maximum monthly payment that I could get under this is this going to be three times my total family income. On some of these loans, that's possible.

For most of these borrowers, that's not a risk worth taking but they don't now have short of running their own amortization programs any way of figuring that out. The current early adjustable rate mortgage disclosures that are provided to them require several steps to get close. We

know from the Consumer Federation study that even educated people consistently underestimate the effect of a two percent rate increase in how much their payments are going to go up by a significant amount.

So if we're talking about people who are credit impaired, they really need to be given in loan specific terms clearly segregated from other disclosures with the TILA the basic information. What's my maximum exposure here? What's going to happen if the worst case scenario happens so that they can then assess along with the lender whether or not this is a risk that they can take.

I want to say a couple other things about the adjustable rate mortgages and why some of the data that we now know about they're so problematic or that suggest that they're incredibly problematic beyond the anecdotal stories that I've just shared with you. The University of North Carolina study that looked at the impact of prepayment penalties a few years ago noted that having an adjustable rate mortgage increased your chance of foreclosure even more than the prepayment penalty. If you have an adjustable rate mortgage, subprime mortgage, you had a 50 percent increase over a fixed rate mortgage of foreclosure.

It's about a 40 percent chance of foreclosure within four years if you have an adjustable rate mortgage, subprime. That does not to me suggest that adjustable rate mortgages in the subprime market are a particularly good vehicle for sustainable home ownership and wealth accumulation.

Another interesting thing is the coefficient for the foreclosure was higher in that study for ARMs than for anything else except FICO scores below 620. It's the only thing that was even close. We did a few years ago, a professor at the University of Illinois, did a study on local foreclosures in Sinclair County in trying to partly tease out why we had seen a doubling of the foreclosures between 1996 and 2000.

And one of the things that's just striking is at the beginning of that period there were no ARMs in the sample that were 600 bases points over the T Bill in the foreclosure sample. At the end of that period in 2000, they made up 55 percent of the sample of foreclosed loans. What that suggests again like the UNC study is that the ARMs themselves are extremely toxic. They are associated maybe with predatory practices or they are not sustainable. But the ARM loans are not sustainable and are leading to increased rates of foreclosure.

We know in addition to these teaser rates which are themselves a little more

exotic that 30 percent of all subprime ARMs are now interest only. We are starting to hear from legal services offices around the country of elderly people, working families, with interest only ARMs. That can't possibly be good. I can't imagine any scenario under which that makes long term financial sense for a low income family.

I think given all of this, all of the problems that we see with ARMs, it is very important that the Board look seriously at improving the disclosures, making the disclosures loan specific so that they are not given generic disclosures, but actually loan specific disclosures so that individual borrowers are able to accurately assess their interest rate exposure and risk.

MEMBER DIXON: Chairman's prerogative here just to respond to some of the data, I have not reviewed that study in detail and I should. I can only speak for the data that we have. We have $100 billion worth of adjustable rate mortgages on our books. Our delinquency rates and foreclosure rates are way below industry norms for other portfolio lenders and for the mortgage business in general.

So I think that the message that I would convey here is that there is a bifurcation in the marketplace. There are responsible versions of these but there are clearly irresponsible, pick your adjective, versions that we fully support getting sunshine and other responses but it's not all ARMs and I will continue to try and raise that issue. So I have first Forrest.

MEMBER STANLEY: I'm just responding on one thing that Diane said. We did have an excellent discussion yesterday about what is meaningful disclosure to the customer of the payment shock effect of the adjustment. As Diane said, there was the thought that putting it in the TILA and showing the actual example of what the payment would be at the maximum rate would be a more meaningful disclosure.

Let's keep in mind that there currently are ARM disclosures that are out there and we have a hypothetical example that's given to try to show payment shock. I think, and I don't want to speak for everybody, that there was a lot of conversation around that that's not a meaningful disclosure to the customer. If it's not a meaningful disclosure to the customer, let's get rid of it.

We constantly talked that we are just inundating the consumer with disclosures and we also talked about yesterday that disclosures going go part way to addressing the issue. But if the early disclosures in the ARMs are something that consumers don't read and throw away let's get rid of them. Then if the more meaningful disclosure is in the TILA let's put it in the TILA. But let's get rid of, we are just inundating consumers with disclosures and I think that's one of the problems

that they have trouble comparison shopping and fully understanding what they get. It's because they just get flooded with information and it's just too much.

MEMBER DIXON: Stella.

MEMBER ADAMS: First of all, I want to agree with Dan in part and disagree in part. I think it is true that the products themselves when appropriately applied can be responsible and can serve a financial interest, be in the financial interest, of a borrower. I think suitability is the key.

But also from a safety and soundness standpoint, we have to look at it. You've been involved, your company's been involved, in this market for over thirty years. But primarily it was a niche market. It was about two percent of all loans which had the exotic features of options and reamortizations and in the way that you used it as a portfolio lender, you had significant down payment requirements and you made sure that you amortized it, indexed it, in your underwriting guidelines because if it failed, it failed on your books.

Now what we have is an explosion in these products with people with not 30 years experience but maybe with how long have these been in explosion mode? Eighteen to twenty months. We don't even have a seasoning of this big set of loans. We don't know what is going to happen when the first reset on these comes about in about twelve months.

But what we do have is we have a real change in the marketplace around who's selling these loans who they're selling them to. You have brokers who once they get their broker fee don't care how it performs. You have lenders who don't care how it performs as long as they disclosed it in their SEC filing and the bond investors who have to be suitable investors. There's a suitability test to be able to buy that bond.

But the person whose entire wealth is involved, the borrower, is not necessarily suitable. I will say to you that I believe it's absolutely unsafe and unsound and it is a dangerous practice. It's not suitable for the subprime market. These are not products suitable for subprime borrowers who we already know are credit impaired or have some other impairment that placed them in the subprime market.

And I don't believe that they understand the sticker shock. One of the problems we have with ARMs as they are today is that most consumers think they understand what an adjustable rate mortgage is. Most consumer's understanding of an adjustable rate mortgage is that it's a crap shoot that they're taking the risk that rates will drop and they will get a benefit and the

lenders is taking a risk that rates are going to rise and they'll get the benefit.

Most borrowers even middle income borrowers who have come and upper income borrowers who come in and have these teaser rate loans, I had one woman. She was like ?In January, my rate is going to go down. So I'm just trying to keep it together until January when my rate goes down and my payments will drop.? Then I looked in her loan and I was like, ?No, your rate will never be lowered than it is right now.? She would have never gone in.

She had a wonderful fixed rate loan that she maybe saved a percentage point on the ARM rate over her fixed rate and she would have never changed into a rate where she knew it was always going to go up and she had no understanding that because it was a teaser rate even though interest rates had gone down she was going to be adjusted to the index rate. She had no understanding of that.

But these are people who think they understand what just a simple adjustable rate mortgage is. They have no understanding of this interest only feature and certainly have no understanding of the option ARM. When you're given the choice of a pay rate of $450 a month or an interest only rate of $1,000 a month or an amortized rate at $1,500. I choose $450 a month.

So the burden is again shifted to the unsophisticated, unknowing borrower and that is becoming more and more of the borrowers as these things proliferate. So I say that we may need to have a suitability standard for borrowers just as we do for investors.

MEMBER DIXON: Kelly and a half a dozen more.

MEMBER WALSH: Okay. Just a couple more statistics about the problem. Non prime borrowers are twice as likely to choose ARMs and option ARMs as those with higher credit scores and they're harmful because of lack of awareness about the possible payment increases. The example we saw yesterday was a $350,000 mortgage at 5-3/4 percent going up by $1,000 a month. People are just not aware of or prepared for that kind of payment jump. And the lack of underwriting to evaluate a borrower's ability to repay that kind of a payment difference is not being considered often.

In 50 percent of the cases of people choosing option ARMs they're making that minimum payment, that $400 minimum payment that Stella was just describing, 50 percent of the time. And according to the Consumer Federation of America those preferring these kinds of loans are less aware of the interest rate risks. Forty-six percent of young adults would choose those products. Forty-four percent of people with incomes under $25,000 a year would chose those

products and 50 percent of people with high school degree would choose those products.

Recommendation from my perspective are I'm very passionate about home ownership and I really believe that everybody who can afford to be in a home should be in a home. But I think that we need to balance our desire to get people into homes with what we're doing to these families long term by getting them into the inappropriate products. I think that we need better disclosures showing them what the worst case scenario is based on their loan amount and I think we need more careful underwriting based on their ability to pay in a worst case scenario situation.

Finally, bankrate.com reported yesterday that $1 trillion in these mortgages is going to adjust in 2007 and that's going to have a huge impact on all of us.

MEMBER DIXON: Elsie was next.

MEMBER MEEKS: Thank you. My whole time on this Council I've felt like I've learned much more than I've contributed and I'm grateful for Dan for having taught me something that there is a place for these ARMs in the prime market under certain conditions and according to Dan quite a few conditions.

But Stella is exactly right that this does not belong in the subprime market and we had a presentation yesterday from bankrate.com that do borrowers understand the risk and I'm repeating what everybody else has but I said, ?Who will tell them?? The realtor, the mortgage borrower, the lender have a conflict of interest and probably won't. We all know that's true.

The problem is that the responsible lenders here around this table feel like we're taking them to task but in fact, we all know where the problem really is. It's with the brokers and some of the subprime lenders.

But this presentation also said who will tell them. Not everyone has an accountant who are competent or trusted financially. But I would almost no one has that. I don't have that. And that the lure of the low monthly payment wins out and my constituency does not see the same. I mean we aren't the same constituency that Dan Dixon deals with. So I was saying to Mark yesterday that there ought to be law. I think there is one, but I think this is a serious issue and of course, financial education is the key here above all. Governor Olson and I had a very brief conversation.

But my remark earlier that I will get to say is I do believe the financial services industry and particularly the Fed can have a real influence on our education systems. This is an issue, financial education or lack of it paralyzes more people, creates more dysfunctions than not

having a great education does. This is such a key issue that it's so frustrating that there's no common or coherent strategy across Federal agencies, across our other walks in life.

This is such a serious issue that I think that we have to figure out, not just talk about how we do this piecemeal. But Stella said it earlier, I want Stella to come to work for me or I'll work for her or something, that we have to figure out how this becomes a part of our educational system, how we start learning this in our schools and I think it used to be but it's not now.

GOVERNOR OLSON: Let me comment on this from a couple of different directions and where we see the Fed's role because we see it in a macro point of view and we also see it in terms of the capacity in our delivery system.

First of all, would everybody here who represents a lender raise their hand? Okay. Now all of you who make ?- No, keep them up. All of you who make money on foreclosures keep your hands up. That's a really important fact, I think, that we need to keep in mind is that one of the inherent disciplines that has been built into the process over the years that particularly with mortgage products, banks very aggressively work to minimize if not eliminate foreclosures because it always results in a loss.

One of the developments that has a multiple implication is the development of the secondary market and the development on the secondary market on the one hand has been the most powerful advance in the mortgage industry that's allowed more people to have access to mortgage products than probably any other single advance.

In recent years, in recent months actually, the proliferation or the numbers of new participants in the secondary market is what has created the demand for this kind of a product and an issue that has been of concern to us is the extent to which risk in those products is being appropriately priced because risk is now being evaluated at an area that is new to the entire system.

So from a macro prospective, I'm sure I can speak for both of my fellow Governors who are here, that is an issue that concerns us a great deal. On the underwriting side, it is not clear that at the initial lender there has been the same requirement for underwriting.

Dan, I think you folks are largely portfolio lenders, are you not, but you can see it in the marketplace. Many of you other I know also sell into the market. So that's one element of discipline that has changed dramatically and the extent to that I think we are watching or monitoring very careful.

On the other side, as the Federal Reserve is changing as every institution is its role

in the economy, one of the things that we're very aware of is the capacity in our delivery capability with respect to financial literacy and financial education. And you see twelve banks around the system and many of their branches, now individually thinking through what we can do with the capacity available to us. So the extent that you have input following up the Vice Chairman's question and also to the extent that you have input on how we can utilize that capability, we're more than anxious to do so.

But there's an enormous asymmetry of knowledge with respect to products like this. There's a tremendous advantage. On the other hand, there's a risk exposure that we need to more fully measure and monitor and that's part of our role.

MEMBER DIXON: Thank you. Kurt, I think you were up next.

MEMBER EGGERT: I was watching the game last night and I saw an ad that struck me as relevant for this discussion. It was an ad for a lender that said with our new loan product you can save up to $16,000 a year by making a minimum payment on your loan. And I thought about that and I realized what they're saying if you have negative amortization which I think was involved in this loan you will save meaning that the equity in your house, you will not save any equity in your house. You will not decrease the amount of your loan.

In other words, what their product really insures is that you will not save $16,000 a year because of instead of putting that money into paying off your loan, most people will take that money and spend it on something else. So what it tells me if they're saying saving means not paying down your loan that seemed dishonest to me and certainly kind of deceptive. But that kind of ad I think is pretty common. I listen to a lot of radio on my long commute to Orange County and the ads for lenders trying to get people to buy these products are very confusing even to me as to what they're talking about.

It used to be that home purchases and paying off loans was a primary source of forced savings for most middle class people. These alternative products are taking that away and making it so people aren't gaining much equity in their home and may actually even be losing equity in their home as they pay their loan from year to year. I think that's a great concern.

Also we've talked a lot about financial literacy. I agree that that's important but it has be balanced on the other side. Making the consumer more literate has to be matched on the other side by having very clear disclosures of what products they're getting. We can't expect people to become more literate and then be faced with a barrage of really confusing disclosures.

Also it has to be balanced I think by understandable products if we're asking consumers to shop. But if the products in the marketplace are so complex that somebody with a Ph.D. in economics can't understand them, then financial literacy is not going to do any good. The subprime market by and large is much more complex and confusing than the prime market.

The prime market traditionally you have your 30 year fixed rate loan and that's what you got. The subprime market has always been a lot more complicated. I think that's one of the reasons why it's less efficient and that subprime borrowers more often end up in loans that their risk does not account for the price of their loan.

In wrapping up, I think disclosure and financial education is important but it's not sufficient. I don't think we can rely on either of those two things to protect people from these complex exotic loans and from getting into bad loans that in the end will hurt them.

MEMBER CANAVAN: Governor Olson, with regard to securitization, I agree with you that this is a huge part of the picture and also the problem. I think the Fed and other Federal regulatory agencies need to have a regular working group with the SEC with regard to securitization and the issues that we deal with.

Securitization is the engine that fuels the economy because it provides cheaper borrowing costs to businesses but it doesn't necessarily produce lower cost for consumers. But the question from me -- I'm sorry. Go ahead.

GOVERNOR OLSON: Go ahead. I'm with you. It would be a diversion to go in that direction but I have to say there is another side to that argument. But please continue.

MEMBER CANAVAN: It does produce more mortgage money in general which is available. But with regard to what we're talking about today, exotic or I would call them toxic loan products which are toxic to all but a few people who could use some of these products as financial planning tools, we have to ask where these products come from because it may be true that there is a demand for these products now but that's the tail wagging the dog.

These products come from the rating agencies pairing with the investment banks. They develop. They have huge research groups and they develop these loan products and then go out and they sell them to financial institutions and say we can sell these products to our investors because there's a good spread here and we want you to offer them. That's where the loan products come from. It's not because people are standing on the block screaming for this type of a product.

GOVERNOR OLSON: But at the end of the day, there's a reckoning because the

risk has to land somewhere and on the front end of the process, those of you who have talked about the appropriateness of the underwriting are absolutely right on. That is the most critical part and that's where the appropriateness of the product relative to the borrower is where the primary responsibility should be.

On the other end, ultimately that loss will end up someplace, not just in the consumer but also in the lender. That has always been traditionally another part of the balance to make sure that there is quality throughout and the mortgage product as Governor Bies indicated has been an area especially in the banking industry the default rate has been extraordinarily low which means the underwriting has been solid.

The question now is the extent to which the risk is being appropriately measured and for that matter appropriately priced. That at the moment is unknowable. But the amount of money that has gone into the marketplace and the cost clearly has come down because of the secondary market unbalance.

MEMBER CANAVAN: But the cost to subprime borrowers has not come down even though the money is cheaper.

GOVERNOR OLSON: That could well be true.

MEMBER CANAVAN: Again the cops on the block in the investment world is supposed to be the rating agencies who are completely unregulated and I think the Fed needs to pair with the SEC and recommend to Congress that the rating agencies are regulated. They're supposed to be the ones that are doing due diligence. I don't think that they're doing a very good job. They are sampling only ten percent of the loan portfolios in most cases and we're heading into a new era where people are getting ?-

In California, why are 61 percent of the people taking out interest only loans? That's insanity. That means we're facing something down the road that we haven't faced before and we are going to be looking at safety and soundness crises.

MEMBER DIXON: A couple of quick comments about some of the points you made, on the securitization side, that is a big change in the ARM business. Historically, there wasn't much securitization going on with ARMs at all. They were almost all, at the 95 plus percent range, being originated and held by the originating companies and frankly it was mostly for a long time the west coast companies.

GOVERNOR OLSON: That was why the term conforming, that was what the

term conforming meant.

MEMBER DIXON: But most recently and I again don't have a lot of data. This is a new evolutionary cycle here but I know our folks looked at one big pool of these new mortgages and instead of having a pool of mortgages being sold through an investor who bought the pool and took the risk, there were something like 13 tranches in this securitization. What that means is just like there are some investors in the equity markets who will buy penny stocks and take a flyer that they could get a huge return, but they could also end up with nothing. There are investors apparently coming in to these securitizations who will make the big bet on the tail and take the chance that they could either get a very attractive payoff on that tail or nothing.

To Sheila's point, there are new sources of investment here that don't have the traditional foreclosure threat to balance their investment decision. They're making a bet for a potential 100 percent yield but they may get nothing. So that is partly fueling as well.

On interest only, keep in mind the growth of home equity lending. I think that there are frankly, put aside all the ?exotic? developments in the marketplace, a huge number of home owners who have tapped the equity in their homes through home equity lines of credit or second more traditional structures and we can have a debate about whether those are appropriate decisions for those consumers. But the fact that they tapped the equity is not new and indeed some of that is a relatively expensive way to do it. The negative amortization on a first mortgage compared if the fixed rates are six, maybe ARMs are five or five and a half and deferring interest at five or five and a half or six percent may be a lot better financial decision for an appropriate consumer, not everybody but for some consumers may be more appropriate than taking out a second at 10 percent to get access to some of the equity.

Now again, it's all about the context. It matters whether it's appropriate for that consumer. We have 100 percent consensus on that at least for the people that are in this room. Carolyn.

MEMBER CARTER: I'd like to follow up on the question of the ARM disclosures that Diane proposed. I think there's quite a bit of agreement with Forrest that the ARM disclosures given now are of very little use. They're not based on the borrowers actual loan terms. They're given way in advance of the loan. They may not be given at all even though the Truth in Lending Act requires the advocates that work with low-income borrowers report rarely seen the advance ARM disclosures in the packets of papers that borrowers bring in. There's no statutory

damages liability under the Truth in Lending Act for failing to make that particular disclosure which may explain why it's given less religiously.

It's not just a question of financial literacy. The ARM disclosures right now are based on a $10,000 hypothetical note on your actual loan terms. When you come to closing what you get is nothing about the adjustable rates except a little statement saying you were given some adjustable-rate information earlier. But you are not told anything else in your Truth in Lending Disclosure Statement at closing and saying that financial literacy will enable the borrower then to figure out what the risk is, is like saying that financial literacy would enable me to multiple two numbers together when you've only given me one. I guarantee you I won't get the right answer if I don't have both of the numbers I'm supposed to multiply together and the borrower at closing knows the actual loan amount but doesn't have the ARM information to multiply it.

In our discussions in committee yesterday, the lenders generally said, in fact I think every lender who spoke said, that they could live with a disclosure regime that required disclosure of the actual worst case scenario in the Truth in Lending Disclosure at closing. The lenders also said that they do not give that information to the consumer now unless the consumer really demands it because it would scare away business.

I think it was also the consensus that yes they would give it. They could live with it but if everyone else was doing it. And if everyone else was doing it then the good lenders would compete just fine giving the worst case scenario disclosure and it would deter probably dishonesty and sharp practice among the bad lenders.

But in order to assure all the lenders that everyone's going to be doing it so they won't be competitively disadvantaged, it can't just be a best practices requirement because only the best lenders will follow the best practices and the lenders that we're really concerned about will not follow the best practices. It needs to be a regulation. It needs to be one that's enforced and enforceable and that means changing the ARM disclosures under the Truth in Lending Act, under Regulation Z, to require the disclosure of the worst case scenario in the Truth in Lending statement.

It's given to the consumer at closing so the consumer then sees what the worst case scenario is and then consumer then can also take it home and during the three-day rescission period, study it more carefully if closing was rushed and again evaluate whether that worst case scenario is something the consumer could live with.

Another advantage is that it could induce lenders to compete on the worst case

scenario if it has to be disclosed. Then the lenders may not place quite as much risk on consumers and may take more of the risk themselves, may cap those adjustable rates to have it with a cap more favorable to consumers.

MEMBER DIXON: Jim.

MEMBER GARNER: First of all, I agree with Carolyn that disclosures can be and should be improved. But I think Stella really hit the nail on the head. This is more of a suitability issue. Disclosures will help but they're not a panacea and they won't solve the problem.

Using Diane's example where you have a fixed income senior who the only way they can qualify based on a debt-to-income analysis that only looks at the teaser rate is just an accident waiting to happen. At Citi, we do not do interest only or neg amortization option ARMs in our subprime channels. We do in the prime channel make interest only loans and to Dan's point earlier, I think that's a very appropriate product for the right borrower that's sophisticated. They know what they're getting into. Their circumstances warrant it and it's an option that should be available to them to make an informed choice.

MS. BRAUNSTEIN: Dan, can I ask Carolyn a question? I'm sorry. I want to follow up with something you said. Carolyn, you were talking about the worst case scenario being disclosed on the TILA at closing?

MEMBER CARTER: Yes.

MS. BRAUNSTEIN: I'm just wondering. Back to an issue we discussed a little earlier, isn't that a little late to be disclosing it to consumers?

MEMBER CARTER: Governor Bies raised that issue and I agree with Diane that earlier disclosures would be a great step as long as the terms are iron-clad fixed at that point. They don't change any between the disclosure time and closing and as long as there is strong enforcement. Another response to your question is that since there is the three day right to cancel after.

MS. BRAUNSTEIN: But not for a first loan.

MEMBER CARTER: No, not for a first loan.

MS. BRAUNSTEIN: And that's what some of these are.

MEMBER CARTER: Yes.

MS. BRAUNSTEIN: That's why I'm wondering. That was going to be my follow-up question is that if you get it at closing you're right there. You're going to buy a property. I

just wonder how useful it will be. You don't get a three-day rescission period.

MEMBER THOMPSON: The concern really is that it would be great to get it in advance. But the problem with the early disclosures is in my experience they're often not given largely because I think they are not strong, self-enforcing mechanisms to insure that they're given and that when they are given, the terms often change dramatically from the early disclosures to the final disclosures. So yes, it would be great.

If it's on the final TILA, you could expect it to be on the early estimated TILA and it should be. That would be great and useful for shopping. But we still are left with the problem that we have now that the estimated TILA is just an estimate and terms can and do change between two disclosures.

MEMBER DIXON: How are we doing on time, Mark? Are we okay?

CHAIR PINSKY: If we can get done by 12:05 p.m. it would be great.

MEMBER DIXON: Yes, I think so. So let's make these follow-ups brief. Stella.

MEMBER ADAMS: I just want to address Governor Olson. I'm a person who works in the community but I try to keep up with the macro economics a little bit and I tell you that $1 trillion in an untested market coming up where you have investors with toxic tranches in the investment where we don't know what percentage of this $1 trillion reset is going to be in that tranche, I don't know that the balances that existed in the ARM market when it was a portfolio, nonconforming, when you kept it on your books, where you had a committed lender committed to the process as opposed to a high-roller rolling the dices.

When you roll the dice like that, you can afford to lose the money. I don't know that the balance in terms of risk that used to exist in the market in terms of the lender and the borrower, that level of risk. That level of risk sharing does not exist I don't believe in this new market and $1 trillion coming out of our neighborhoods and communities one family at a time can be devastating the overall economy because it's been the equity that's fueled the economy and we're not building any wealth anymore.

There has to be something done to manage, I think this is a real risk and I am so scared about what's going to happen when that $1 trillion recess because this is a new market. It is a secondary market that did not previous exist. It is handled in a way that is not the way traditional ARM lenders handle the market.

MEMBER DIXON: Kurt.

MEMBER EGGERT: Two quick points. One is on the early disclosure issue. I think early disclosures are good. However if you look at the aggressive marketer, it's easier for them at the early disclosure area to say don't worry about this. This is just some form thing I have to show you. The real paperwork will come later. So I think it's great to have early disclosure but I don't think you should rely on it instead of having disclosure at the time they're signing when people say this is the real thing and I have to worry about this now.

The other point I wanted to make is that I'm very worried being a Southern Californian about the impact of these new products not only on individual borrowers but also on the housing market as a whole. We've seen in Southern California that a huge percentage of people are using income only loans in order to get into a super heated market and my great fear is that in a couple of years as these borrowers are suddenly having to pay a fully amortized rate and their loan payment increases, at the same time we're going to see a drop in housing prices and so they will be paying more for a house that's worth less and you'll see a lot of people upside down. That could have a very horrible effect on them and on the state.

MEMBER DIXON: Anyone else? I'll try and summarize. From the responsible lending standpoint, we are very appreciative and applaud the interests of the Federal Reserve and the other bank regulators in getting into this issue. There clearly are evolving practices in the marketplace which are, pick your adjective, irresponsible and inappropriate.

The fact is that ARMs are more complex than fixed rate loans and the fact is that consumers have different circumstances. So it is impossible that we could come up a rule that says this is the loan that everybody should get, not with regard to the product features nor with regard to the pricing. But clearly there are practices that have evolved in the marketplace that need attention. The issue is bigger than just the institutions that are regulated by the bank regulators because there are other players in the market that are not subject to that oversight.

Disclosure and suitability are big issues where we have an opportunity I think and indeed a responsibility to really pursue those strategies to try and address these concerns and it's to make sure we don't throw out the baby with the bath water. We've studied our ARM portfolio over the last 20 years. We've looked specifically at customers who took our product versus a customer who took the prevailing fixed rate product at the time of origination.

We've compared how they did from the date of origination to current. We update those chart every six months and there are two months in twenty years where the fixed rate customer

actually turned out to be marginally better off even assuming they refinanced every time it made sense for them to do so. The fact is well designed, appropriately structured products with appropriate consumer protection features can be financially superior for consumers. But what we've seen lately in the marketplace isn't part of that setup business. There are problems out there that deserve your attention and we appreciate your interest. Thanks.

CHAIR PINSKY: Thank you, Dan. Thank you, everybody for a terrific discussion about what clearly is a new emerging issue that this Council and all of us are going to have to continue to pay attention to. One of the things as we begin planning for this meeting right around the time of the first hurricane Katrina and since two more major hurricanes was really to spend a little bit of time talking about particularly Katrina as an unprecedented disaster meant for all the work that we do, for the work of the Fed and the Fed has responded. Many banks have responded. Many community groups have responded and I think we all personally have responded each in our own way.

So we tried as a full council to capture some of that and figure out how to distill it into something that we can now cover in twenty five or thirty minutes and I asked Lori Swanson, our Vice Chair, to take charge of that and to try and distill it and she's done a wonderful job. I'm going to turn it over to Lori to facilitate this discussion.

MEMBER SWANSON: Thanks, Mark. As we talked about the issue yesterday, all of us, our hearts really went out to the folks who have suffered and are continuing to suffer from these disasters and as we had our discussions yesterday, I think we all felt a sense of humility talking about some of the issues because it really is such a catastrophic disaster that occurred and requires a very global massive response to it and in some ways, some of the points that we discussed seemed somewhat small in some respects.

Nevertheless, that having been said, I think we did have some real good discussions about some concrete things that can be done in the future as it relates to disasters and to summarize, I think there were three broad areas where the discussions occurred. The first was in the area of financial institutions and consumers, second in the area of housing and the third in the area of community development and CRA. I'll briefly recap what those discussions were and then start off the discussion actually in reverse order with community development and the CRA.

In the area of the financial institutions and consumer matters, there was a fair amount of discussion about the need for cash, to access cash, that that was a very important

immediate need of those who are displaced and we spent a fair amount of time talking about some of the ways that both traditional financial institutions and others have stepped to the plate to assist in making cash available.

We talked about the impact of the disaster on credit bureau reporting, what it means to consumers who get behind on their debt because of the disaster and then also identity theft and fortunately there was a lot of discussion about whether identity theft would really take off in the wake of the disaster. But based upon our discussions yesterday, people weren't able to report that that's occurred. Maybe it will. Maybe it's too early. But so far, we didn't get those reports.

In the area of housing, we had a fair amount of discussion about unscrupulous building contractors who are preying on these kind of disasters and how steps may be taken to help avoid that and also a fair amount of discussion on the area of deferments of mortgage payments both in terms of who's qualified, benefits of uniform standards and the impact on lenders of continuing to make advances when the debtors have been given forbearance.

And then in the area of community development and CRA, it was a very timing topic because of the 2005 amendments to the CRA regulations which expanded the definition of community development to include activities that revitalized or stabilized a designated disaster area and also the fact that interagency Q&As are to be worked on with regard to a CRA in disaster areas.

We discussed that a disaster area is defined as a federal or state disaster area under the law but we had a fair amount of discussion about ways that definition may need to be amended in terms of how long an area should stay a disaster area given how long it takes to revitalize communities and then also whether there should be different rules in place for catastrophic disasters that affect an entire region versus more localized disasters and whether there should be flexibility to go outside of normal CRA areas to help disaster areas respond particularly where when you have a catastrophic event (1) people leave that area to go to other places and that (2) financial institutions in the disaster area may not be in a great shape to actually respond, they may be tapped out or maxed out, and then also whether there could be additional guidance given to financial institutions as to how to really make a difference when it comes to community redevelopment when you're talking a disaster of this scale.

So that sums up what the discussion were yesterday and again, the thought would be that we try to take these topics in reverse order talking about community developments and CRA first, then go to housing and as time permits, talk about some of the other miscellaneous financial

and consumer issues. With that, Marva, did you want to jump in on the community development issue?

MEMBER WILLIAMS: Sure. I think Lori summarized most of the discussion that we had yesterday regarding this. As she mentioned, the community development now includes reinvestment in disaster areas and this includes economic development, affordable housing and community services. Although we recognize that it's going to take a lot more than CRA to rebuild these communities, we think that's an important component of the resources that are going to be needed to rebuild these devastated communities.

We're also very much looking forward to seeing the Q&A that's being written on this area and very much would like to participate in that there are four main areas that we identified. First of all, Anne stressed the importance of transactions services particularly immediately after the disaster occurs that people really need cash and other kinds of transaction services and then as things progress they need loans and investments as part of the rebuilding effort.

We also talked about the geographic dispersion of evacuees as Lori mentioned and that many of these activities may not actually occur in the disaster area but for instance many of the Katrina evacuees are in North Carolina, in Illinois, in Utah and Oklahoma and many other communities across the country and they are in need of all kinds of financial services.

The third area was what is the tenure of the designation. Stella made the point that in North Carolina with the experience that they had with Floyd that a 1e or 20 month period of the designation might suffice. But with Katrina and some of the other more recent hurricanes, a much longer intervention period may be necessary and so there needs to be some set of criteria that can be developed to actually define that tenure.

The last thing we talked about was the need for creative and innovative and complex interventions on the part of financial institutions and this is an important component of the Community Reinvestment Act to encourage banks to look at more innovative and complex deals and I think that this is even more necessary when it comes to rebuilding disaster areas.

We all know that all investments are not created equally. Some investments, some grants, some financial services and loans have a greater impact than others. So it's important for the regulatory agencies to provide some guidance I think for banks and some encouragement to participate in more innovative and impactful activities.

MEMBER SWANSON: Okay. I have Stella and then Bruce.

MEMBER ADAMS: I just wanted to clarify. Floyd was about seven years ago and we're still recovering from it. If you can imagine that for Floyd which affected thirty-three counties, you can imagine the impact and the length of time it's going to take to revitalize the Gulf Coast states. So it's important that we don't just limited it to the FEMA timetable but look at the long term investments in revitalizing communities. To me that is the critical piece.

There is sort of the three step process in CRA. The first place where lenders can really be involved is in immediate services to the victims and they should be getting CRA credit for those kind of immediate service things. The intermediate step is helping with small business loans and some kind of bridge loans for FEMA-related, government-related services. Then there has to be the long term community reinvestment development.

What we don't want with these disasters is have two categories, the catastrophic disasters and then the tornado-in-a-five-mile-radius disaster which can be doing that FEMA period of time, that one or two year period. But when you know that you're looking at long term, ten, fifteen years worth of investments that we allow those investments to be given the special CRA credit and that we allow institutions from outside of the region to come in and make investments in that area as well because that's a good place to put investment dollars when you have that investment task.

MEMBER SWANSON: Bruce.

MEMBER MORGAN: Yes, Lori. I did not participate in Katrina as a financial institution but I was involved in the main stem flooding in `93 that occurred. But we did meet with Fed product directors and some of the banks involved in Katrina this week and basically there are three phases of a catastrophic disaster like this, the immediate phase which we're still not out of yet, the short-term temporary phase is people are dislocated and they have to make a decision whether they're going to return to the region and long term.

The Federal Reserve has a critical role and they perform very well in the payment systems but as any type of major operation, we have to debrief and when some of this settles out, we need to have lessons learned not only for the Fed but for financial institutions. For example, one of the things we've learned at Katrina is that electronics don't work. When you have no power, when Sprint loses two switches and no telecommunications, you can't deliver a payroll file to a financial institution for the company's employees. The ATM machine is under water. You can't get cash out of it. Without power, without communications, it doesn't work.

So what people have relied on, there were 108 institutions initially inoperable in three Gulf Coast states, they relied on cash and checks. The Atlanta Fed volume went from four million checks a day, one million in New Orleans which is still closed, the New Orleans branch is still closed. They're handling eight million checks a day. So we've moved back to paper. But as we continue in the payment systems to move towards more electronic alternatives, we're still going to have to keep a MASH unit out there in the event of a disaster to help us move paper. You can't get armored cars in the area if you have no security. It makes no difference if you try to keep it open with a generator if you have no fuel for the generator.

So in this immediate impact, there are a lot of things that the Fed can do. One of them is make sure we have equal access to all the payment system services for all banks regardless of size. Higher priority to banks in getting reestablished. We have to get commerce reestablished in the Gulf Coast states. That requires power. That requires communication.

Finally, on the structure and supervision side, that's the short term and long term. There's going to have to be some capital forbearance to those institutions that need to help this grow. The Fed has done a great job, but I think we're still very early on in understanding the long term impact of Katrina.

MEMBER SWANSON: Thank you. Kelly.

MEMBER WALSH: We were talking yesterday about what incentives the Fed might provide to encourage financial institutions to provide additional support in these communities and it seems to me one thing you might consider is encouraging banks through some flexibility in CRA to finance mixed income housing in these communities. It might be a way to help stabilize the communities in a better way long term since we have to start from scratch.

And CRA really just focuses on affordable housing and does take into consideration that affordable housing is in mixed income properties. But if we really focused on the development of mixed income properties it would be a good thing.

MEMBER SWANSON: Thanks. Jim.

MEMBER KING: I think one of the things that the banks could do and the Feds can do is take the leadership in setting a tone for rebuilding this community. If you think about it, we are about to rebuild a city. The discussions are still do we do that. The answer is probably yes.

Those people who live in that area did not build those properties there. They were there before and those who built those properties realize at some point in time this would probably

happen. To those who own property build someplace else.

But what we have to do though, we realize in this process there's going to be a lot of fraud. We have a Congressman present in my community who said he's facing all these bills, this fact that you can't put pork onto these new bills to help New Orleans. But his definition of pork was Section 8 housing. So that's a tone he's setting for what we're rebuilding. It is not designed for poor people. It's not designed for a city because the percentage of poor in that city is 60 percent.

So we have a problem that the banks have to take the lead on and have the ability to think out of the box and act out of the box because this is building a new city and things that we do now as norm is no longer true. All the things we work with today will not apply. We have to create new ways by which we do things.

MEMBER SWANSON: Dan.

MEMBER DIXON: Just to build off actually a combination of the last two, I think the logistical issues of getting some of the basic financial payment system functioning, all that's very important. But I think that there's no doubt that we'll sort that out and we'll learn. We learn every time we go through one of these. We learn from Florida, etc.

The Federal Reserve of course is famous for its discretion in considering important policy matters. But I must say it seems to be the best kept secret of all time if there is any work that can place on what is the big picture solution here and it's not just the Fed of course. It was an inappropriate singling out this body.

But the fundamental question frankly is the people who had assets lost them. The lenders who had mortgages in that market in many cases have no value left and the concept of reconstructing the community, there is a big hole and nobody is hearing that I'm aware of how we're going to fill that hole. We can encourage lenders to be creative but there's no developers. The people that were from that community don't have any resources to come ask for a loan unless it's 130 percent loan or a 180 percent loan because they still have the old loan.

So I think the biggest challenge obviously is to get onto that. The more we delay the more small businesses are cooked. They can't come back. The residents have relocated and reestablished their lives and the kids are in school someplace else and they're not coming back.

So if we're going to reconstruct, and that's the vision, then let's start talking about the real question which is how are we going to finance it. Where is the money coming from to fill the big hole that has now been created by that flood in New Orleans? From my standpoint, my

company doesn't have a big presence in that part of the Gulf Coast. They have a big presence in Texas and Florida but in between.

But from afar, it looks to me like there's a real difference between what the challenge is in the city of New Orleans which was under water for a month versus even frankly as bad as this sounds the reports that we're getting from Florida from Wilma is they've had quite a lot of practice and they have proven that they pretty much will recover from that. It's not easy. It's not without challenges but it's not unprecedented or even Texas and the Gulf Coast of Texas. And as much as there are issues there, it's not like it's completely a black and white distinction.

But the real big difference, what's new and different here is New Orleans. I don't hear the solution for that.

MEMBER SWANSON: Okay. I have Hattie and then we'll open it up to anyone who wants to jump in. I need a housing related issue, a mortgage deferment issue and certainly the other financial or consumer issues. Hattie.

MEMBER DORSEY: I guess the other side of it and it's building a bit on what Dan just said is the credit worthiness, the future credit worthiness, when somebody has lost everything or the industry has gone by the wayside where they once upon a time held jobs but they're still being held responsible for payments even if they're relocated or even if they're going to move back.

I don't know what the purview of the Feds is in this kind of quandary that we find ourselves as we respond to this disaster but on the other side of it, how do we, going back to what Jim said, help a community rebuild and help the people who choose to rebuild as well, return and rebuild a life and restore some of the equity that floated away. The problem is critical as any that the United States has had to face and all the systems within it has had to face in our lifetime.

MEMBER SWANSON: Mary Jane.

MEMBER SEEBACH: I would like to follow up on what Jim and Dan were saying. What Dan called it yesterday was when do we begin the discussion of how we're going to recover and I think that's right. I think the Fed and the other agencies have done a great job at addressing the most immediate needs. As a mortgage lender, we've been working with other mortgage lenders to talk about things like uniform forbearance standards so that no single borrower is disadvantaged.

The flip side of that issue is for the large lenders the issue of advances to the

investors is not a big issue. It's a critical issue for either small banks or small lenders in the community who don't have that kind of money, certainly don't have money coming in right now that they can use to advance to HUD or to the GSEs or to private investors. They may not have borrowers making payments. They don't have small businesses doing business. They are probably on the edge anyway but as we lose those small lenders who have the best understanding of the community and who are going to be the most critical part of rebuilding that area, we're already setting ourselves up with yet another hurdle.

I want to follow up on what Dan was saying. We've all felt just an incredible frustration. We all have done whatever we can do in terms of forbearance, in terms of not reporting on credit bureaus, in terms of waiving fees, in terms of all of the things that are positive that the Feds set out.

But we're very concerned about tomorrow. We'll hearing the polls that are saying the community is not coming back and we're all concerned about reports when we hear that the mayor of New Orleans is going to go through and start ripping down buildings. We don't know what tomorrow is going to bring. We don't know when the Federal Government is going to tell us whether or we have environmentally safe areas which is going to recolor the whole argument.

But there needs to be a discussion about what's the timetable for reaching whatever the end goal is and I think there needs to be a national discussion of what that end goal should be. There are discussions that perhaps certain areas can't be rebuild, shouldn't be rebuild, because they're in an area where they're going to get flooded again. We shouldn't have built there in the first place. If that may be one of the topics on the table, then we do have to deal with where are those people going to live and where are there jobs that are going to take care of those people. Where will they be?

It just all seems at this point like there's a very piecemeal discussion and that I'll just say that it seems that Congress is taking more of a step of looking at who possibly could have been to blame for the failures that we have here as opposed to focusing the larger picture of now where do we go and where do we get the assist to help rebuild and redirect ourselves. So I'm kind of hoping as we move through the Feds's have been tremendous at identifying issues and helping to respond to a lot of the issues for banks.

But I do hope the Fed takes its role on the public policy arena to hopefully influence that we need to move towards the end solution so that we can all work towards it because I

do think the lending community is ready to it. We're just caught between knowing are we going to get paid out on the assets or are we going to have to rebuild or is this flood insurance or is this wind insurance, the whole issue that we singly can't do and then the issue of whether or not they're coming back at all.

MEMBER SWANSON: Thank you. Diane.

MEMBER THOMPSON: Yes, two, I'm afraid, piecemeal points and small points. One is we brought this up yesterday and to bring to the Board's attention as well the study that ACORN did approximately a month ago that suggested that subprime lenders were not being as forthcoming with forbearance as prime lenders and that that was not surprisingly having a racially disparate impact. They were finding even in wholly-owned affiliates of national banks big differences between what the customers of the national bank were offered and what the customers of the subprime affiliate were given after specifically requesting forbearance which is of concern as we think about the rebuilding and the question about who gets to come back and on what terms people get to come and are allowed to rebuild their lives. Are we going to accommodate all the citizens equally or not?

The other issue is a little more perspective which is I know that there was some discussion in early days about whether or not the Fed would relax the standards for the waiver of the right of rescission and I was pleased that the Fed did not do that. I would encourage the Fed not to relax the rules for the waiver of the right of rescission. We know from experience in Florida with other hurricanes that the predators are lining up, that usually the barr on getting the work done is not that three days getting the money but that there's only a limited number of reputable contractors and there's only a certain amount of building supplies. So I applaud the Fed for holding the line in this case and I encourage you to remain firm on that point as the work in New Orleans goes underway.

MEMBER SWANSON: We probably have a minute left. Is there anyone else who wanted to jump in on any of these topics? Anne.

MEMBER DIEDRICK: I frankly am now sitting here thinking maybe we should write a book on this. We were, Chase was, right in the thick of this. We have 224 facilities in Louisiana, 85 were in New Orleans with 1,100 employees.

I'm also sitting here thinking about the heroes in our firm who worked seven days a week not for one week but four months through Labor Day weekend. In one weekend alone, we delivered $50 million to people who were the victims of New Orleans through other branches and

ATMs.

What I'm proud of and what I think is the good thing about large banks is they can quickly mobilize resources and very quickly deal with a crisis, not that we haven't had those before. My own office is two blocks from the World Trade Center where we had a branch in 9/11. It was so enormous for us and it's of course enormous every single day for us as we work through the issues.

But I have to just say that Charlie Sharp who runs our retail banking business immediately took control of what needed to be done not only to find our own employees who were scattered all over and taking out newspaper ads and *U.S. Today* and working with our customers but working with customers of other financial institutions who didn't have branches outside of New Orleans and moving the customers accounts to other places where they had moved. People moved all over the country as you know and they needed access to their bank. So there were probably a million different things that went on and still go on with this but there is something once and a while good about the power of a large financial institution that can step in and very quickly mobilize in the wake of a crisis.

MEMBER SWANSON: Governor Bies, I think you had a question or a comment.

GOVERNOR BIES: You've all and I won't go through them all for the sake of time, there are some great comments and suggestions of ways to move forward. The one thing though that I would ask you to help us think about that I haven't heard is what is the role of Federal policymakers in all of this because we traditionally have said the urban planning is what cities do, it's what counties do, it's what states do as opposed to the federal government. So one of the things about is where to belong and where are we going and how do we work together and as a person whose PhD in economics is in urban economics who's married to someone who's initial degree was in urban planning, I get very nervous when we think people sitting here in Washington have more wisdom about the future of New Orleans than the people who are there both at the parish and state levels. Somehow we have to find a way that we in our roles in the federal government and as regulators are supporting what the vision is for that local community.

To the extent that all of you in your different hats that you're wearing can help encourage that dialogue to get going. They've been responding to the immediate crisis which is what we would expect them to be doing. But this transition to the way forward is now becoming more and more evident because it may reflect on the way we respond as bank regulators to

alternatives that are laid forward for us. And so we need to be very alert to what are these emerging issues.

This is a little bit different in New Orleans this time as you've mentioned. We've been trying on the supervisory side to really take in comments and concerns and we've heard some of the issues and we've been trying to respond. You will probably find many more quick little notices that go out on different things. But you're right. The long-run vision of where we're going is probably the one piece that we're not getting a lot of input on but it could clearly influence the way we look at different supervisory responses and the way we work to forebear on individual institutions and so on. We need to know what the long run opportunities are.

I just wanted to add that as another context about the role of all of us sitting in Washington versus the role of the local folks. We want to be responsive and I just want to send the signal that the more we can start that dialogue I think it would help all of us moving forward more effectively together.

MEMBER DIEDRICK: And, Governor Bies, I know because our market leader in that market is working with other leaders in New Orleans to round up ideas of how we all can support them. But it's their vision. It's their community, I believe.

MEMBER SWANSON: Governor Bies, I thank you for that perspective and commentary. I thought that was very helpful. Let's see. Faith, you had your hand up and then Chuck and then Stella and then we probably have to wrap it up. So if we can fairly quick. Faith, you've had your hand up for a while.

MEMBER ANDERSON: And I do again want to commend the regulators and the Fed for what they all did in that catastrophe because it was very helpful setting up the 800 numbers and the frequently asked questions that our members or customers could go to, to be reassured that their funds were still safe at the financial institution. However, some folks didn't have computer access because they were away. So maybe the Fed could set up, if there's any other events like that, computers where people could access the internet so they could see the questions or knowing that their institution was still there and the funds that were still there.

And also as Bruce had mentioned, capital forbearance is a big issue, I know, with smaller financial institutions that were especially just located in New Orleans and all their customer members have left. No one is taking out loans because everybody is gone and they still have to pay dividends or interest on the deposits but they have no money coming in.

Another one is that although we haven't seen that much about identity theft we think that it still might be an issue down the road because we don't know what was left in mailboxes since people didn't evacuate because they didn't think they had to until the very last minute. So there could be credit cards or statements that were left in the mail or still in their house, important documents.

Also it would be helpful for financial institutions if you could give additional guidance on business continuity and disaster. I know we all have disaster recovery plans but I don't think any of us have our disaster recovery plans where the whole city is taken out or your whole communications are down. So I think if you could publish something on what you saw were the best practices and what other financial institutions could work on, that would be very helpful.

MEMBER SWANSON: Chuck.

MEMBER GATSON: I normally don't say much because if I do, it's redundant because Hattie and Stella and Diane always get to say what I want to say because they're a little bit quicker on the draw. But specifically to your point about what can the folks in Washington, the first thing they could do is appoint a secretary of the Department of Housing and Urban Development that understands urban development. That would be a good thing to do first of all.

It seems to me that there are no resources in New Orleans. There's no resources in the State of Louisiana to deal with the issues and problems of rebuilding that city. So it is a Federal issue. It is a federal job from my perspective to lead that effort and to finance that effort because without the leadership of the people in Washington, without the money that the people in Washington have to put into those kind of efforts, it's not going to happen and again we need leadership at the federal level to make these things happen. They can't be done totally at the local level.

MEMBER SWANSON: Stella, I think you had your hand up and then we have to call it here.

MEMBER ADAMS: Just really quick. I just want to reiterate what Mary Jane talked about and Chuck to a certain extent. (1) We need to point out that the GSEs and the FHA are not doing their fair share to help the community bankers in those communities. They're still requiring advances from those small banks and at least our government secondary markets should be forbearing on those small lenders even if we can't influence. I think part of the tragedy that Diane talked about is because Wall Street is not granting forbearance to those subprime lenders and that's

why they're not granting forbearance to the borrowers.

MEMBER SWANSON: Thank you, everyone, for the commentary. I think we all recognize again the disaster is on this enormous scale and everybody had great feedback and ideas and thoughts and I particularly appreciate the Board allowing us to carve the time out of the agenda to tackle these issues and discuss them. Thank you for that.

CHAIR PINSKY: Thank you, everyone. Thank you, Lori. One more issue that I think is going to continue to stay on the Council's agenda as we go forward clearly. Let me make an perhaps inappropriately quick transition to the next part of our agenda and as Lori is going to be doing a presentation, I think all Council members and the Governors have a copy of her presentation at her seat. We'll turn it over to Lori who is going to talk about the role of state attorneys general regarding the financial services industry.

I'm glad, Lori, that you can do this. I appreciate it. Just so everyone knows, when Lori is done we'll have a chance to ask her a few questions. We'll do very brief committee reports, a chance for those of leaving to say a few words and then we'll adjourn.

MEMBER SWANSON: I will get started. As Governor Olson knows, I'm from Minnesota. So the good thing is I talk fast. I'll try to get us back on track here.

GOVERNOR OLSON: And we both speak the English language the way God intended it.

MEMBER SWANSON: Exactly. I like your accent. Anyway, I wanted to talk about the role of state attorney generals and just our office in particular and some of the issues we've gotten involved in, how attorney generals get involved in issues, why we get involved in issues and particularly run through a couple examples of some of the cases we've gotten in.

Chief Counsel to the state agencies, attorney generals wear many hats. Probably the least known hat is as chief counsel to the government at the state level. So if you have a commerce department, a banking department, in your state, it's going to be the AG nine times out of ten giving legal advice and opinions and then also prosecuting actions on behalf of those agencies when they go to court.

Other areas, legislative advocacy. If you hear complaints from the public about a particular area and there are problems areas, attorney generals can get involved, write legislation. We've done that in Minnesota on a variety of issues from some data security breaches to financial privacy, you name it.

Another big area and not a well-known area is consumer education which goes to Governor Ferguson's question about literacy. We do a huge amount of outreach trying to educate the public. It's a lot cheaper and more efficient to do that up front than it is to deal with the problem after the fact. A good example of financial literacy working which is a federal law is the FACT Act which required everyone to get a free credit report. Because of that, groups like ours would jump out front. I probably did a dozen media interviews on the topic and because people knew they had a right to a free credit report, they learned about maybe I should get at what's in my credit score and so forth.

And then the area that attorney generals are probably best known for although it's probably the least amount of their work is enforcement of the state consumer protection laws. How do they do that? Consumer complaints, most AG offices have big intake areas where they get complaints from the public on a host of different areas and it runs the gambit from car dealers to health-care to you name it. It can really be anything. In fact, we always say when there's a full moon out we get complaints. So we're a one-stop shopping center in that regard.

Then of course, actions can be brought by one state attorney general on their own or they can be brought by a regional or national multistate. There have been plenty of cases where fifty AGs have teamed up to take an enforcement action together, other cases where just one AG goes alone on a particular issue. The benefit of teaming up is you can share resources, expert witnesses, discovery and what not.

The core consumer protection laws are pretty similar in every state, laws against consumer fraud, false advertising, deceptive trade practices. In a nutshell, they basically don't make representations that aren't true is how I would summarize it. A lawyer wrote those laws. It's been around a lot longer than that but that's how I would summarize them.

Some example I thought might be of interest in our work to the CAC, mortgage foreclosure fraud is a huge problem in Minnesota and in many other states. I think Carolyn's group NCLC is sure to report schemes foreclosed about this growing epidemic of mortgage foreclosure fraud.

What happens is these scam artists will go to the courthouse. They pick up lists of people who are in foreclosure. They then target them with schemes designed to steal the equity out of their home rather than the person in foreclosure actually working out of the problem or in some cases selling their home and preserving their equity.

These scam artists will come along and steal the equity through a variety of different schemes. They first will contact the person in foreclosure again by getting public records that they're in foreclosure. They'll show up at their door, knock on it, build trust and confidence by saying ?I know you're in trouble. I can get you refinancing. I know nobody else can but I have the magic bullet and I can get you refinancing.?

Then what they do is employ a variety of tactics to not get you refinancing and steal the home out from under the debtor. One way they do is by running the clock on the statutory redemption periods. They will say ?Your refinancing's coming through. I just need a few more pieces of paper? and so on and so forth and ?Don't worry. You've still have some time left.? And at that very last minute, maybe the day before the redemption period expires, they'll basically present the debtor with a contract for deed where if the mortgage payment was $800 the month before, the new contract for deed is $1,500 a month. It's a deal designed to fail. The person can't pay it. The next month they lose their home to the scam artist.

In other cases, they'll literally whip out warranty deeds and tell the debtor that they're signing a power of attorney for example when they're not. They're actually signing a deed to their home over to the bad guys and it has been a devastating thing for our community and it has affected all kinds of borrowers in our community. We've taken about six enforcement actions against it to basically try to (1) get the people's homes back. That can be hard if it's been passed on to a bonafide purchaser. The home is probably gone. But (2) we've pursued injunctive relief to try to stop the conduct and put these people out of business. And then (3) you try to get restitution, try to get whatever assets that people have.

I say it's an epidemic because I think it's going on in every state where people's homes are being stolen in this fashion. To deal with it, we got a law passed too. That's the second bullet down that legislative advocacy. We got a law passed to essentially take the profit out of this kind of scheme to say that if somebody enters into one of these deals and they don't get their home back, that the bad guy doesn't get to keep more than 18 percent profit which has substantially ramped down on this kind of activity. So that's one example of one of the kinds of areas where some of these laws have applied.

Another area is what I call credit card marketing and debt collection practices. It also goes to the issue of financial literacy and Kurt's point about the ad you saw last night at the Sofitel, the save $16,000. I think it's important to keep in mind we have all kinds of advertisements

that are very confusing and that often times take away from financial literacy and make it difficult to be an informed consumer.

Laws are pending now against one particular credit card company. They offer credit cards to people in the subprime market to improve their credit. So they go after people who have bad credit to begin with and say that we will improve your credit. Then they tell the people that you've been preapproved for a generous credit limit of up to $2500. In fact, I think only 3 percent of the people get $2500.

Forty percent get nothing at all and the reminder get an average of $400 credit limit. Then what they do is tack on very substantial fees to the account immediately upon account opening. I think there's $100 origination fee, a $50 annual fee. They're tacked on right away. So now the $250 credit limit has really become maybe a $50 or $100 credit limit and the consumer doesn't know those fees are tacked on. So they go out and charge $150 TV.

Now they're $30 a month over. They pay their over the limit fee and very quickly this credit card designed to improve the credit actually creates a reverse consequence of just financing fees and destroys their credit.

Then on the back end once that happens and the fees are tacked on there's very aggressive debt collection practices that have been employed against the consumers. I think we have about 200 complaints in our office. The New York Attorney General's office has about 400 or 500 complaints, everything from swearing at consumers, using every word in the book, calling people on Easter, Christmas. One person got twenty seven calls in thirty minutes. Another person worked at a hospital. They kept calling the debtor at the hospital. The administrator said ?Don't call here. You're tying up the phone lines.? ?We don't care.? Calling people racial epithets. Telling one person you talk like a black person. She said, ?What does my race have to do with it?? And they said, ?You people are just like that.? Just horrible things. Threatening to revoke green cards. Very difficult conduct. So that was an example and that bank has been sued I think by seven attorney generals in suits that are pending. So that is another example of using some of the consumer fraud and consumer protection laws to go after our bad actors.

It is again trying to look at the big picture on some of these cases we take and it is that financial literacy that when you have advertisements out there for this type of product that it dissuades people from taking more legitimate products or more suitable products and making them into good consumers and it affects the savings rate that we talked about being nothing. You look at

some of the conduct out there and it's difficult for consumers.

I'm going to fly through a few of the next ones. My task is to get us back on time here. Just real quick, two more examples. We recently entered into a settlement agreement, Iowa, South Dakota and Minnesota as an example of regional multi-state, with a bank that had served as a merchant's bank on behalf of some very fraudulent telemarketers. Telemarketers would call up and impose unauthorized charges that the consumer didn't want and the return rates were extraordinary, much higher than the market would indicate. And of course, these telemarketers are very hard to catch. Often times, they're in other countries or operating boiler rooms in Canada.

So the agreement with the particular financial institution, under that agreement the institution will do a whole bunch of due diligence before agreeing to be the merchant's bank, screening them, are there complaints with the Better Business Bureau, looking at their telemarketing scripts and then on the back end, monitoring the practices for excessive return rates. So essentially the financial institution with our office is becoming partner and trying to root out bad telemarketing practices in a way that's really effective because it's very hard to ramp down on a telemarketer but a financial institution sure doesn't have an incentive in enabling that type of activity.

Then another area along those lines that's going on right now is this issue of mailing to consumers a small check. I don't know if anyone has gotten one here but raise your hand if you have, like two or three dollars. If you get one of them, what happens is I hope no one cashed it because if you cash it and you sign the back of it, you got one?

CHAIR PINSKY: Several.

MEMBER SWANSON: Very good. And that is a trend. It used to be that there would be sale of information from the financial institution to the telemarketer. Then that was kind of stopped. Now what's going on is that the financial institutions, some of them, will enable these vendors, these membership clubs, to send these checks and they're like $2, $3 and if you cash it, you've enrolled yourself in an auto renewing membership club to the tune of like $80, $90, bucks a year for discounts on products ranging from computers to what not.

The problem with that is that if you try to market the membership clubs in a real straight-up fashion, very few people are going to buy them. So there have been some schemes developed to try to sell them to people in a way where they don't necessarily understand that they're consenting to it.

Then predatory lending, I think that was the whole morning. So I won't go there.

I think I may have gotten us back on track.

CHAIR PINSKY: We'll fall behind again. Don't worry. Questions? First of all, Lori, thank you very much. When you talk fast enough, you can probably move back east if you want. Are there questions for Lori about that? Stella, please.

MEMBER ADAMS: Just one. There's a lot of preemption going on of state attorney generals' rights to protect consumers and I just think the role of the attorney generals, particularly your attorney general and mine in North Carolina who have taken on these lending cases from the beginning have been so crucial in developing the arguments for predatory lending in legislation that it's a shame that there's consideration of taking away attorney generals' rights to defend their citizens.

MEMBER SWANSON: Thanks for the commentary. I'm obviously, at the state level, not a fan of federal preemption, particularly federal preemption where there's no substantive regulations. So preempt the states but then don't regulate us, I'm obviously not a fan of that.

CHAIR PINSKY: Hattie, you have a question. Please.

MEMBER DORSEY: Lori's presentation prompted me to ask a dumb question perhaps. Governor Olson asked the question about how many lenders make money off of foreclosures. So my dumb question is why then would a lender ask for the consumer at the closing table to waive their right to due process under foreclosure and that question I think is prompted by the fact that the State of Georgia has one of the most egregious foreclosure laws that you can be foreclosed in one night.

GOVERNOR OLSON: I think you've answered, I would defer to Lori on the legal part, but my understanding is that foreclosures are governed by state law, I think, in all states. And you can see a wide range of state laws. It is my experience that most states particularly with respect to banks, bank lenders, are very aggressively protecting the right of homeowners in the foreclosure process.

But I wasn't aware of the extent to which this sort of scam is going on. There are very few in my experience foreclosures where there is equity. But where you have a combination of equity and an uninformed homeowner, there is a real opportunity there for abuse. I think for a state attorney general to go after those types of instances is a very important part of the process. I'd already talked about the first part of that. But the states have a lot to do with the extent to which those laws are effective.

MEMBER DORSEY: And I think your presentation also prompted me to forward this information to our state attorney generals to ask that very question.

MEMBER SWANSON: Good. Thanks.

CHAIR PINSKY: One last question, Carolyn.

MEMBER CARTER: This isn't a question. It's a comment that I really want to commend and applaud Lori's office. They're an exemplary office and really vigorous in their consumer protection work.

CHAIR PINSKY: Thank you for that.

MEMBER SWANSON: Thanks.

CHAIR PINSKY: What a great way to end. Lori, thank you. It was great. We're going to spend a few minutes just quickly running through committee reports. We'll start with Mary Jane if we can start with you.

MEMBER SEEBACH: Certainly, when we come back next year, we're going to have more of the same. We're going to be hitting quite clearly a lot of the topics we talked about today. We're going to come back and talk about some of the policy implications of the HMDA data clearly that were raised during our discussion today and I won't go into all of those.

We'll additionally have additional discussion on the alternative mortgages, more on the disclosures and how we can really address that and then the outreach part of that about financial literacy and maybe how we can partner with the Federal Reserve System to insure there's better curriculum on mortgage products. I think that would be a really good thing.

And then also on Katrina. I think the community redevelopment, the how do we recover question will be with us next year.

CHAIR PINSKY: Thank you, Mary Jane. Forrest.

MEMBER STANLEY: I won't go over what we talked about yesterday because it's going to be an ongoing discussion and that's identity theft. We had a very good discussion around it and I think it's obviously an area that could continue to evolve and we will continue to discuss it at future meetings as well as the Hurricane Katrina issue, in fact, just generally on disasters on the payment systems. That's within the purview of DDS. I think that will be a recurring topic.

We also will be teeing up Check 21 as it becomes more prevalent throughout the industry, the effect on consumers of Check 21 and whether or not there needs to be any further regulation there as well as some issues around signature based debit and Reg E will also be on future

agendas.

CHAIR PINSKY: Thank you. Dan.

MEMBER DIXON: We talked in the consumer credit committee about two of the issues that were on the agenda today, the alternative mortgages and Katrina. In addition, we spent some time chatting with staff about the pending rulemaking on the bankruptcy provisions related to the Truth In Lending Act and the minimum payment disclosures on opening credit recognizing that that's much easier said than done because of the complexity of the terms and structures of a lot of the opening credit accounts.

For future meetings, I think that frankly a lot of the current issues will be revisited one way or another. There are still some open rules on the FACT Act pending and so I assume that we'll spend time on that at the appropriate time with input from staff and there is any of a variety of issues around Regulation C, Truth in Lending Act. There's open rules pending and I think that's almost a constant for the consumer credit.

CHAIR PINSKY: Thank you, Dan. Anne.

MEMBER DIEDRICK: Okay. Thanks, Mark. We're hoping that next time that we get to spend a lot of time in a practical way on CRA and particularly on focusing on the services test both retail banking services and community development services understanding what's going on with those and focusing on the unbanked, the use of money service businesses and alternative banking services.

And we're also going to hopefully be able to talk about financial literacy. I was so thrilled this morning to hear both Vice Chairman Ferguson and Governor Olson say how important this is to them and it's important to the people on our committee as well. So maybe we'll be able to start exploring best practices. I think that all of us in one way or another are probably pretty involved in it. I know at our bank we give away millions of dollars every year to not-for-profits that provide it and we have people who are full-time provided in the bank. But it doesn't seem to be as coordinated in the marketplace as it should be. It's very distressing that it isn't better coordinated. So maybe we can come up with some best practices next time.

CHAIR PINSKY: Thank you, Anne. In closing, let me just begin and I want to then open the floor to everyone for whom this is the last meeting and let me just very briefly say first of all to the Governors and the Board, thank you for the opportunity to serve. It's really quite an honor and a terrific experience.

To the staff, Sandy, to you and to Ann and Terry and Adrienne, I can't thank everybody. I made a mistake by thanking anyone in person. You do an extraordinary job. You prepare us well. You treat us well. You help us along and support us and it's just wonderful.

And all my co-council members, it's really an honor to serve with all of you. I feel like as Elsie said earlier that I've learned so much more than I possibly could have contributed. But I think the proceedings of this council and my three years on it have really been a model for how a civic and a policy dialogue can happen and happen in constructive ways and we can seek to find ways to understand each other. So I just want to say thank you and then I want to open it up to other retiring members. Jim.

MEMBER GARNER: I will just echo the same remarks by and large. It's been an honor to serve and certainly, I know Elsie had to leave earlier but I echo the same comment there. I've certainly learned more than I contributed. But I also wanted to commend the staff. I think they do a super job and a lot of hard work and coordination goes into that. The preparations for the briefings they do, they just do a phenomenal job. Thank you for that. It's been very helpful to us as council members.

To me one of the most important things about serving on the council is the relationships you develop over the three year period which I know they extend beyond the three year term because we've already had relationships with some and hopefully it will remain if we still stay in contact with us. So thank you very much. It's been an honor and a pleasure and just sorry that the three year term, the three year seems about right I think for the length of it to make sure you get new people on and get fresh input. Thank you.

CHAIR PINSKY: Diane.

MEMBER THOMPSON: Like everyone else, I think I've certainly learned a tremendous amount. I'm very grateful to the board and the staff for that opportunity. I'm more grateful however for the board's willingness to listen to the concerns of the clients I represent.

As I think all of you know, I represent low income consumers, people at 125 percent or less of poverty and these are people who have very little access to policymakers at your level and I have felt that over the last three years it's a tremendous privilege to be able to try to convey to you some of their concerns as well as a tremendous responsibility to try to do justice to the lives that I see come into my office of single working moms who are trying desperately to make a better life for their kids and making decisions between paying the mortgage and fixing the roof and

seniors who are faced with the prospect of losing their home of fifty years because of an unscrupulous home improvement contractor.

I am tremendously grateful that you have listened to those concerns with the amount of intellectual curiosity and open-heartedness that you have shown. I think it is very difficult often for many of us to see or hear what the experience of poverty in America is like. It is not something that most of us have any daily contact with and it is often largely invisible to all of us. I'm very grateful to you.

I hope that as you go forward you will make sure that those voices continue to be represented on this Council. In the 2000 Census there were forty-five million Americans at or below 125 percent of poverty. That's the LSC eligibility guidelines. That's a lot of people who have really very few other ways to access. They don't have the resources to hire lobbyists. They don't have the extra time to write comment letters by and large. This is one of the few places where I think their voice gets heard in economic policy.

The other thing I would say about that is legal needs surveys overwhelmingly show that the number one problem that low income people have is consumer issues. Over and over again, that is the plurality of the problems that they experience, that they identify as their legal problems. They are swamped with all kinds of legal problems including all of the scams and then some that Lori identified in her speech and that doesn't include home improvement or predatory lending which falls under housing needs and that's the second largest area of need. Thank you.

CHAIR PINSKY: Thank you, Diane. Chuck.

MEMBER GATSON: Again, I'll try to be redundant and thank everybody two or three different times like other people do. But I will say when I came on the council, I had a very clear understanding of CRA and how it affected what I did for a living. I spent the last twenty years of my life in urban redevelopment in Kansas City, Missouri and when I started banks didn't talk to me very much. But as time went on and they had to respond back to CRA on the CRA issues, it became very much easier for me to get money from them and that's all I really care about, the banks getting from them and I'll tell you I don't have any problem telling you that.

But in my tenure on this particular council, I've learned more acronyms, EGRPRA, TILA, more regulations, Z, P, B, C and I am more conversant with that kind of stuff than I was obviously several years ago. Service on this Council actually caused me to go back to Kansas City and raise $50,000 a year over the last three years to fund an FLO, we call it a ?flo,? Financial

Literacy Officer. Before my service on this particular council, I didn't really care much about that because I was too busy digging holes. So this has caused me to change my perspective a little bit and definitely the acronyms. Thank you.

CHAIR PINSKY: Clint and Susan and Dan.

MEMBER WALKER: I also would like to echo what my colleagues have been saying. First of all, I'd like to thank my colleagues. First of all, it's been fun when credit organizations have come up to spar with some of you. It's always an enjoyable experience.

But more importantly, following what Diane had said, it's also been very helpful for people like me to see issues from a different perspective and that's extremely helpful to get different people's perspectives on issues that affect their clients day-to-day that makes us all better.

I would like to thank the Governors. I find it remarkable that you all three come to every meeting. It makes serving on this Council more worthwhile to know that you actually are being heard.

Then finally I would like to thank the staff. I've been dealing with some of the staff for years, but it's given me a new appreciation for them, how not only hardworking and thoughtful they are but frankly how difficult a job can be and how well they are managing at coming up to speed on the issues of managing the whole thing and coming up with very thoughtful issues. I've really enjoyed that. Thank you.

CHAIR PINSKY: Susan.

MEMBER BREDEHOFT: My remarks are redundant but they come from the heart. I really would like to thank the Federal Reserve Bank of Philadelphia for nominating me to this position. I truly appreciate it. Again, I want to thank Board staff. Their performance in pulling these meetings together is truly phenomenal. I'd like to thank the Governors and my fellow Council members past and present for making this a truly valuable and memorable experience.

CHAIR PINSKY: Dan and Jim. And then we've run the tables.

MEMBER DIXON: I won't be repetitive. I think the experience in my case certainly exceeded expectations. I was anticipating a positive opportunity to have the interchange industry consumer advocates and with the participation from the staff and the Governors but it certainly has exceeded that. And frankly, my suggestion is if there are ways to expand participation perhaps at the district level and there may be more of that already going on that I'm not aware of. But the more people that can gauge in this type of process where we get what are otherwise

adversaries in the room at the same time not on a transaction but on the policy discussion, I think it can only be very helpful. Thanks for the opportunity.

CHAIR PINSKY: And, Jim, last word.

MEMBER KING: Last one. First of all, it's been a pleasure to be here. When I came I got on two committees that I had no idea about and I learned more about them. I listen a lot and that's an unusual for me to have to sit and listen. So I don't do that very well.

But the process is a great process, to have looked back at the last year and the year before kind of reflects on me being in the business for twenty-five years, how things were twenty-five years ago and how they are today and without knowing it this process has been part of the change. We started and banks would not talk to us. We would do twenty units of houses and how to pick up five banks at the table to share the risk. Now I get calls all the time about are you doing a deal, can we get involved. That's change.

Changing people by a product is change and it says more education. Things have changed. There are people who have yet to grow to understand the process but I think this process is part of that. The Governors come to listen to us, not only listen, put into action something we can all think about. We all complain sometimes. We talked about the same things two years ago we're talking about now. But that's part of the process of change.

So I really want to thank the staff and the Board and all my partners here for letting me be here and be quiet and listen.

CHAIR PINSKY: Thank you, everyone. Good luck to the Council going forward. Lunch for Council members is in the room down the hall as always and we'll talk. Off the record.

(Whereupon, at 1:10 p.m., the foregoing matter was concluded.)