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FRB Transcript of the Counsumer Advisory Council Meeting

Lorie R. Swanson

Lisa Sodeika

Stella Adams

Dennis L. Algiere

Faith L. Anderson

See next page for additional authors

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Author/Creator

Lorie R. Swanson, Lisa Sodeika, Stella Adams, Dennis L. Algiere, Faith L. Anderson, Dorothy Bridges, Tony T. Brown, Shiela Canavan, Carolyn Carter, Michael Cook, Donald S. Currie, Anne Diedrick, Kurt Eggert, Sarah Ludwig, Mark M. Metz, Lance Morgan, Bruce B. Morgan, Joshua Peirez, Anna McDonald Rentschler, Faith Arnold Schwartz, Mary Jane Seebach, Edward Sivak, Paul J. Springman, Forrest F. Stanley, Anselmo Villarreal, Kelly K. Walsh, Alan White, Marva E. Williams, Sandra F. Braunstein, Ben S. Bernanke, Mark Olson, and Kevin Warsh

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TRANSCRIPT OF THE

CONSUMER ADVISORY COUNCIL MEETING

THURSDAY, MARCH 30, 2006

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., Lori Swanson, Chair, presiding.

Members present:
Lori R. Swanson, Chair
Lisa Sodeika, Vice Chair
Stella Adams
Dennis Algiere
Faith Anderson
Dorothy Bridges
Tony T. Brown
Sheila Canavan
Carolyn Carter
Michael Cook
Donald S. Currie
Anne Diedrick
Kurt Eggert
Sarah Ludwig
Mark K Metz
Bruce B. Morgan
Lance Morgan
Joshua Peirez
Anna McDonald Rentschler
Faith Arnold Schwartz
Mary Jane Seebach
Edward Sivak
Paul J. Springman
Forrest F. Stanley
Anselmo Villarreal
Kelly Walsh
Alan White
Marva Williams

Others present:
Sandra Braunstein, Director, Division of Consumer and Community Affairs
Ben Bernanke, Chairman, Board of Governors
Mark Olson, member, Board of Governors
Kevin Warsh, member, Board of Governors

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9:05 a.m.

CHAIRPERSON SWANSON: Good morning everybody. I think we will go ahead and get started here with our March CAC meeting. First of all I want to welcome everybody, welcome the returning members and welcome the new member who I want to introduce in a moment. But first of all I would like to acknowledge and welcome the Governors who are with us today. Chairman Bernanke thank you and welcome. Governor Olson, I thank you for being here and welcome. And Governor Warsh, thank you and welcome to you as well. We very much appreciate your attendance and appreciate your time.

I'd like to introduce the ten members of the Consumer Advisory Council who are new to the Council.

Dorothy Bridges of Franklin National Bank of Minneapolis, welcome.

Tony Brown of Uptown Consortium in Cincinnati, Ohio. Welcome, Tony.

Sarah Ludwig from the Neighborhood Economic Development Advocacy Project in New York.

Mark Metz from Wachovia Corporation in Charlotte, North Carolina.

Lance Morgan from Ho-Chunk, Incorporated in Winnebago, Nebraska.

Joshua Peirez joins us from MasterCard International in Purchase, New York.

Anna Rentschler from Central Bancompany in Jefferson City, New Jersey.

Faith Schwartz from Option One Mortgage here in Washington, D.C.

Edward Sivak from the Enterprise Corporation of the Delta in Jackson, Mississippi.

And Alan White from Community Legal Services in Philadelphia, Pennsylvania.

So welcome to all of you, our new members.

I think we had a great day yesterday of Committee meetings with very robust discussions on these topics that we're going to discuss today. And it should be a very exciting and full agenda we have today.

The first topic here on the agenda is home equity lending hearings. The Home Ownership and Equity Protection Act or HOEPA establishes certain requirements for certain high cost mortgages. And under HOEPA the Board is required to hold periodic hearings on the home-equity lending market and the adequacy of existing consumer disclosures and protections.

The last hearings took place in the summer of 2000 and in 2001 following those hearings, the Board issued rules extending HOEPA's coverage to additional lends and strengthened substantive consumer protections as well.

Members of both the Community Affairs in Housing and Consumer Credit Committees yesterday discussed potential hearing topics for proposed upcoming hearings that the Board will be holding on this topic this summer. And with that, I would like to introduce Mary Jane Seebach, the Chair of the Community Affairs and Housing Committee, who will start us off on our discussion.

Mary Jane?

MEMBER SEEBACH: Thank you, Lori.

The Board is considering holding the next round of public hearings this summer, and Board staff has asked for the Council's feedback in determining the scope of those hearings, keeping in mind the Board's focus on authority to address disclosures as well as some limited substantive provisions staff has set forth four general principles or goals for us to be accomplished by these hearings.

First, the hearings would be helpful in assessing the effectiveness of the 2002 HOEPA revisions in protecting consumers as well as the rules impact on the availability of credit in the higher cost end of the subprime market.

Next, it would assist the Board in its review of the Truth and Lending Act rules, more specifically the rules governing closed-end home mortgage loans.

Third, it would help identify circumstances where the Board or other entities might want to develop additional educational materials for consumers.

And fourth, it would help identify areas where it would be beneficial to engage in additional research on consumer behavior in the home mortgage lending market.

To begin this morning I'd like to offer the Council an opportunity to comment on the goals as articulated by the staff.

Carolyn?

MEMBER CARTER: Thank you Mary Jane.

I think the goals are very important because they set the tone and the expectations for the hearings. My view is that the goals are fine as far as they go, but are phrased in an overly modest and cautious way.

I think the goals don't really express what the Board wants to know and should want to know about home equity lending. I'd suggest that the goals of these hearings should be to find out are there problems in the home-equity market? Is there a fraud? Is there predation. Why? If there are these problems, what are their causes; what market forces, what lack of consumer protections lead to these problems?

Third, are there steps that the Fed can take and should take to deal with abuses in the home equity market? Amending the HOEPA regulations, using its authority under HOEPA to prohibit unfairness and deception? Using its general authority to prohibit unfairness?

So these are more expansive goals, but I think they would be goals that would lead the Board to go more to the heart of the questions that it should be asking about home-equity lending.

MEMBER SEEBACH: Thank you.

Sheila?

MEMBER CANAVAN: Yes. First of all, I do agree with what Carolyn has said, but I would like to comment on the goals as they are now particularly the fourth goal, which states that the hearings could identify areas where it would be beneficial to engage in additional research on consumer behavior in the home mortgage lending market.

I would like to reinterpret that goal to state that we also need to obtain an understanding of financial industry participants' behavior as well as the consumer's behavior. I mean, we hear a lot on the Council about how to fix the consumer. You know, sometimes I think we're talking about drilling a hole in their head, pouring in some information, whatever. Maybe that's a good idea, but I think that before we do that we have to understand the marketplace that the consumer interacts with and to properly produce educational materials for one thing.

So I would suggest, for example, that we have some participants at these meetings who can discuss how and why new loan products are introduced into the marketplace. And I would recommend bring in participants from the rating agencies, from the GSEs, as many secondary participants, perhaps even some large institutional investors. Someone that can help provide a broader understanding of how our mortgage market works. Because for example we talk about the primary market. I think we have to change the terminology. The secondary market is really the primary market, because it has such a substantial impact all the way down through the mortgage industry.

Another thing, I think that we need speakers who will talk about what the financial incentives are in the marketplace, both for banks who are selling mortgages in the secondary market and also things such as the compensation structures for loan salesmen who are operating in the primary market. Who is the consumer interacting with in the marketplace? What are the hiring practices in the industry regarding loan salesmen? What are the training practices? Are standardized scripts common? How are loan sales people compensated?

I think it's very important for the Fed to have this information. I've spoken with some colleagues, and I hope that we all help to make these hearings as broad and successful as possible.

MEMBER SEEBACH: Thanks, Sheila.

Anyone else want to comment on the goals before we go into the substantive sections? Great. Thank you.

Now we're going to turn to the more specific areas of discussion, which again the staff has conveniently divided into four areas for us.

The first section we're going to talk about is HOEPA and predatory lending generally. The staff wants us to focus in on and help focus the discussion for these hearings on the impact of the HOEPA rule on curbing abusive lending practices and on the availability of subprime credit generally in the market. And I do want to make sure everyone is reminded that we're generally talking about authority to revise disclosures and improve disclosures that are available as well as a limited authority to curb certain abusive practices. And with that, I'd like to open up. Stella?

MEMBER ADAMS: Thank you, Mary Jane.

I think that this is one of the most important areas that the Board can take up and use its authority. And I hope that they will take this opportunity to have a panel of state regulators from states that have introduced since the rule revisions to HOEPA, introduce anti-predatory lending laws to get a kind of state of the industry or state of the regulatory environment in terms of what are practices that are generally considered abuses now in the marketplace and have been through best practices or through settlement determined to be abusive practice to try to drive them out. And that this be an opportunity for the Fed to use its limited authority. I don't know how limited it is. Use its authority, it has it, to say clearly in the last five years these times have become defined as defined and we will now define them as abusive practices. And use that authority that is available to then codify for the entire industry what may have become what are the best practices and what have

become the new models based on settlement agreements from the AGs across the country. And take what is the best of the currently existing state laws and incorporate them into new HOEPA as recommendations.

MEMBER SEEBACH: Thanks, Stella.

Let me go to Alan and then Faith.

MEMBER WHITE: Sure. On the subject of predatory lending, I totally agree with Stella's point that it be very instructive to hear from states, not only from the regulators but from the industry participants and consumers on how they view the impact on the market of those different state laws.

I think stepping back a little bit the subject of predatory lending, particularly in my state and my city, is very much intertwined with the growing problem of foreclosures. And there's been a fairly dramatic increase in the time that I've been practicing in foreclosure sales. They've doubled in the last ten years in Philadelphia, for example, at a time where the economy has been in pretty good shape in a fairly benign environment.

The Pennsylvania Banking Department has done some research and issued a very good study and report on the foreclosure problem and linked it very closely to the increase in subprime mortgage lending in general and in predatory lending in particular.

One of the findings, for example, of the study was that the subprime loans in Philadelphia County in 1998, in the subsequent five years 40 percent of those loans ended up in foreclosure. And with those kinds of numbers I think that there's a tremendous amount of risk built into some of these loan products, particularly the subprime mortgage products and particularly in certain geographic areas. In addition to inner cities we've seen high foreclosures in the Katrina states, for example, even before obviously the current situation. I think it'll be very instructive to see how the impact of those large numbers of defaults plays out and how sort of the embedded risks in these new products kind of reveal themselves in that kind of a stress. But I think it's very important to look at how the regulatory environment has in the past perhaps either contributed or failed to deal with these risks and what kind of new risks appear in the kind of mortgage products that are being developed now and sort of linking that to the national goals of increasing home ownership. I think there are some loan products that are not particularly helpful to the goal of increasing home ownership. And the foreclosures that result from loans, most of which are not purchase loans, most of which are loans to get cash or to refinance existing mortgages, I think that's a very important

subject to look at and to see what might be done through regulation and through other means to deal with the foreclosure crises.

MEMBER SEEBACH: Faith?

MEMBER SCHWARTZ: Yes. Following Alan's comments, I think it's probably important and constructive for the hearings to also address the growth of the market, where it was less than a decade ago, the spread of risk to what like the Ginnie Mae or the Fannie Mae, Freddie Mac rates and where the rate and point in fees were less than a decade ago in a market that has grown tremendously, more than double-digit per annum. And I think over the past year it was at least in excess of $600 billion or over 20 percent of the residential loan market and rates hovered right above Fannie and Freddie rates. That's astounding based on where it was at 500 basis points in excess of standard prime rates, again maybe five-to-six years ago.

So the market, along with its evils, it has problems that its incurred in some states and others has also brought some health and growth into an industry and home ownership across the board. And we can't ignore that. So I think it's really important that these hearings do address the capital markets, why the markets have compressed, why they're converging and what we can do to make them better markets, including a new HOEPA trigger that works for both consumers and lenders to make loans available.

MEMBER SEEBACH: Mark?

MEMBER METZ: Mary Jane, I just want to go back to a point that Stella had made. The point she was making as a lender in terms of a national objective standard, we would very much welcome that. To the extent there's a level playing field that applies to all lenders, we are very much in favor of that. And to the extent we can have objective specific standards that we can meet, the clearer it is, the better it is for us and we are happy to comply with that.

MEMBER SEEBACH: Great. Thank you.

Yes, Alan?

MEMBER WHITE: Anticipating maybe the discussion of nontraditional mortgage products, but in this context I think it's also important to talk specifically about the role of prepayment penalties and adjustable rates in driving risk and driving foreclosures, and also to some extent being involved with abusive practices.

You have in the subprime market now I think the standard product is an adjustable-rate mortgage with a prepayment penalty, probably 80 percent of the loans in that

segment have those characteristics which are not necessarily to my mind the product of an informed consumer choice. I mean, why you would want to have an adjustable rate when you're paying a high rate because of your hopefully temporarily bad credit and in an environment when you can't normally expect interest rates to be going much lower, that doesn't strike me as the product of well informed rational consumer choice, but it also creates tremendous risks of the payment shock that could and may very well occur in that segment of the market.

We also have some research that's come out recently about prepayment penalties linking those directly to foreclosure risk and the mechanisms for that I think are easy to understand. When you don't have a prepayment penalty, someone who runs into financial difficulty with mortgage has essentially a put option or the option to sell their house or refinance. That options becomes obviously much less attractive when you have to pay something equivalent to three or four or five percent of your principal balance in order to prepay the loan.

And there's also some disturbing information about prepayment penalties in relationship to the disparate racial impact of how those are sold.

So I think prepayment penalties and adjustable-rate mortgages as features of mortgages in general really ought to be looked at. And I think there are also some regulatory solutions. Some states have actually taken action, particularly on the prepayment penalty sides. So we have this natural experiment now where you have some states where they're legal and some states where they're not, you can see what that's done to pricing and to credit availability. And I think that's a very important topic to look at, particularly when you talk about Mark's suggestion, which is to let's create a national standard for unfair and abusive practices. The question of what are we going to do about prepayment penalties is naturally going to arise.

MEMBER SEEBACH: Kurt?

MEMBER EGGERT: I think also in the hearings whenever you're talking about predatory lending, one of the things that should be discussed is how do we assign the risk of predatory lending? If you have an abusive lender who scams a borrower, who should bear the risk? Should it be the borrower or should it be the industry that buys the loan from the lender?

As we have gone to more and more securitization the financial industry has gotten better and better at reducing risk by pooling it, by slicing and dicing it so each party knows exactly what risk they have, and they're essentially insured against the risk of loss for an individual loan. We haven't seen the same thing for borrowers. Borrowers if they get cheated in many instance once the

loan is sold, their recourse is only against the original lender. If the original lender disappears, they're stuck with a loan that they have to repay even though they may have just been lied to in getting the loan. So any discussion of predatory lending has to talk about that.

When we're talking about a national standard one of the things that we've seen from state-to-state is incredible variation in what's called assignee liability, which is how much liability does the assignee, the purchaser of the loan take.

I'm concerned about a national standard that doesn't include that because some states have included that in their state laws and the borrowers have really benefitted. And so I'd be very weary of a national standard that wiped out those important protections for borrowers.

MEMBER SEEBACH: Thanks, Kurt.

Carolyn?

MEMBER CARTER: I pass because I think my point fits in better with the next set.

MEMBER SEEBACH: Okay. All right. Tony and then Julie?

MEMBER BROWN: Yes. I don't know if I can really add more value. I think that the points that were raised have all been good points. And my only concern would be that the hearings do provide a good balanced discussion.

I think that the issue of credit availability is extremely important and that issues that allow for the sale of loan, the securitization of a loan all deal with how a specific loan is structured. The issues of prepayment penalty are related to the more complicated aspect of how do we keep capital available to provide subprime lending.

I thought Sheila made a point about the standards related to mortgage brokers. I think that the responsibility for those that are buying loans and what they do in their corresponding lending agreements and the terms and conditions that they put on mortgage brokers and the types of loans and what they will purchase all creates, more or less, a pricing ceiling so that you don't necessarily gouge the borrower when there is a cap on the amount of premium that any purchaser will pay for a loan. So I think all those standards are important.

We need to understand that the particular loan transaction, that there are aspects to it that need to be mitigated for those who purchasing the loan in an effort to securitize the loan in order to make capital available for subprime lending.

MEMBER SEEBACH: Thank you.

Sheila?

MEMBER CANAVAN: And to add something to that, what Kurt said with regard to the original lender and the borrower having only the original lender to deal with in addition to bankruptcy, the original lender who sold the loan has no incentive and often times no authority to work anything out with the borrower because of the terms and pulling and servicing agreements. So, for example, they cannot modify a loan without the authorization of the owner of that loan. That's a big problem for a borrower.

And the disincentive also is that if you have a lender with some pretty touch practices and a lot of borrowers are complaining to them and they're trying to modify loans, well they're going to have to buy back all those loans. So, again, there's a disincentive because of the terms in the pulling and servicing agreements and the other secondary market contracts that the original lender has. So it's a terrible situation for the borrower and the attorney that's trying to help them if they're fortunate enough to have one.

MEMBER SEEBACH: Thank you.

Stella?

MEMBER ADAMS: I, too, wanted to piggyback on Kurt and on Sheila's comments related to just what happens to the victim. And it may be very, very important to have a victim panel to kind of talk about where justice is served in terms of you've gotten rid of the many cases we have been successful in getting, the mortgage fraud participants prosecuted by the U.S. Attorney and we've been able to get civil penalties against some by the U.S. or the Attorney or the AG. But the borrower, because the original lender is not the holder of the note, does not get any relief. They say so does this mean they're going to fix my loan, and that doesn't happen. So we have to figure out a way to bring some equity to the borrower so that the risk of failure of these loans does not fall 100 percent on the borrower.

It does appear that everybody in the chain but the borrower has some insurance or some other mechanism to protect their investment, except the borrower. And that's something that we need to highlight in the hearings and hopefully address through recommendations at the outcome of the hearing.

And we cannot leave the mortgage brokers in their role. They don't have a dog in the hunt after they've put together the transaction, whether that transaction fails or survives is of no interest to them because they've got their money and they're out of the game. But the borrower and

the lender are left with all the risk. So their role and their increased role in the market should also be examined.

MEMBER SEEBACH: Thank you.

Paul?

MEMBER SPRINGMAN: Thank you.

As we listened on regulation and trying to standardize regulation to govern practices and products, you have to flip to the market side as well. The products that we see today and the practices we see today are going to change tomorrow. It's just the nature of the market. And as we try and come up with regulations that try to point to a specific problem, that problem is gone away in the future because the lenders and borrowers are going to come up with some other way to try and satisfy that market need.

So if you look at regulations, I guess, I'll go to what Mark was saying, is try to come up with guidelines that inform the consumer the right way so they understand what costs are and what the terms are of the loan. But you can't regulate every behavior and try and run the market that way.

MEMBER SEEBACH: Thanks.

Faith?

MEMBER SCHWARTZ: I just wanted to comment on the servicing of loans. For the majority of the top ten lenders or so in the segment of the market that have a majority of the market, they're often originators and servicers of those loans. And I know option 1 carries both balance sheet risk, reputation risk. And while we passed some laws as to investors, we have teams of people that are customer advocacy people who intervene to any foreclosure and work toward modifications and workouts, and we work closely with the investor community, as do most large nonprime lenders. Because we can't resell. We have to be able to sell our loans with good reputation, good performance, and good metric to the market and make sure we're taking care of our customers.

So I think there are those examples that Stella has noted, no doubt, but I would say that the market makers and people who are doing a lot of this business also have a very vested interest in keeping people in homes and preventing foreclosures.

MEMBER SEEBACH: Forrest?

MEMBER STANLEY: I think it's going to be important at the hearings for the Fed to hear from consumers how they found out about various products and what they understand

about those products. You know, that's a critical component, it seems to me, of financial literacy and financial education which I think we all preach. To find out where consumers get their information, whether they receive the information, whether they understand of their options.

I do think in the hearings, I mean know the Fed's going to be open and balanced. But I think an informed consumer can very easily choose an ARM product even for a subprime loan. I think it is not correct to say that it's got a per se unsuitable or not the appropriate product in the subprime market. An informed consumer should be able to make that choice.

I agree that on the issue of disclosures, and I think we all do in having an informed consumers. But I would never want to jump to the fact and brand any product bad.

Remind this is also safety and soundness. ARM products have been in the market for a long, long time. I would not want the link to be that the ARM products have somehow sprung up. Because of the subprime market, there are many lenders that have made ARM products for years and are primarily prime lenders, and those products have been very well received and have been very advantageous to the borrowers. It's all about choice.

And I hope that the Board, again, learns from these hearings exactly how consumers find out about products and then what they understand when they find out about products so we can be a better advocate and we can do more for financial literacy.

MEMBER SEEBACH: Thank you.

Mark?

MEMBER METZ: Yes. I guess following up Forrest's point and also in the point you had made Stella, what can we do for consumers? Because as you were saying, the protection. I think the protection is that we have some and maybe we can make it better. I think there was almost agreement on this yesterday. To the extent that we can improve disclosures, let's do that, but again let's have it sort of standard uniform so that people understand what they have to do and then we'll make it. That would certainly help the consumers.

And to the extent that obviously that people understand what they're getting, they're just that much better off.

MEMBER SEEBACH: I'm going to interject here that one of the issues that I think really needs to be addressed in the disclosure section is disclosure on prepayment penalties.

The lenders at this table I'm sure all offer a reduction in rate or points in fees that accompanies having a prepayment penalty on the loan. And that is the trade off for borrowers. But

it's only a trade off if borrowers understand they have that option. So the disclosure should very specifically require that the borrower be informed. They have an option of whether or not to have a prepayment penalty and whether or not they're getting a savings in either rate or points. It's something our company does, and we find it very effective in talking with our consumers.

And with that I'm going to go to Tony.

MEMBER BROWN: I think Faith hit on it. And I just want to just reiterate that there's three components in this transaction. And we say borrower/lender but there's also the investor. And sometimes the lender is not necessarily the investor.

And when you add on the issue of credit availability is that what the discussion and the hearings are to eventually get to are what are the factors that appropriately mitigate risk and what is the degree of compensation for that risk to be mitigated. Because in this transaction it's the investor who will set the terms and conditions.

MEMBER SEEBACH: Thanks, Tony.

Carolyn?

MEMBER CARTER: I would like to follow up on the comments about ARMs and about disclosures.

ARMs are highly common in low-income mortgage lending. And they impose great risk on the consumer. The consumer is very likely to lose his or her home if the interest rate goes up. Yet, the disclosures that the Truth in Lending Act requires for ARMs are very, very weak. The consumer is never told the worst case scenario, what the payment will reach if the interest rate goes up to the cap. And in fact, the disclosures about the fact that it is an adjustable-rate mortgage, that simple fact is also a very, very weak and non-prominent disclosure and many low-income subprime borrowers are unaware that they have an adjustable-rate mortgage. So the risk is being passed on to the consumer and the consumer is not informed fully of the nature of the risk and may not even be aware of the risk at all. A very dangerous situation.

At the last Board meeting Diane Thompson, a Consumer Advisory Council member who is now off the Council, asked the Board to amend Regulation Z to require disclosure of the worst case scenario for adjustable-rate mortgages. And the adequacy of existing Regulation Z disclosures for nontraditional mortgage products is one of the items that is mentioned in your memo as one of the topics for this hearing.

My view is that adjustable rate, that inadequacies in the adjustable-rate mortgage

disclosures go well beyond nontraditional mortgages and that's a problem for all adjustable rate mortgages.

What I want to urge the Board to do is make it explicit in these hearings you will be considering an amendment to Regulation Z that requires disclosure of the worst case scenario for adjustable rate mortgage. Make that explicit with an eye to doing that this year, not in connection with the general Regulation Z closed-end credit review, but this year. This is a little piece that could be carved out and especially with the growth of the nontraditional mortgages is something that I think there's some urgency to do.

My view is that disclosures alone are not sufficient, but disclosures are something that are clearly within the Board's authority. This is clearly an area that needs improvement. It creates dangers for consumers, dangers in the marketplace that that risk is not recognized and not disclosed, and not dealt with. And it's something that I urge the Board to do on a priority basis and to do in connection with these home equity hearings.

MEMBER SEEBACH: Thank you.

We're going to do three more. Kurt?

MEMBER EGGERT: I would like to build on something that Faith and other people -- there are good subprime lenders. Nobody disputes that. There also have been, unfortunately, some bad subprime lenders. And the challenge is how do you design the rules to give the good subprime lenders a competitive advantage over the bad ones? How do you design the rules so that the people who play fair, who treat their customers well do better than the ones who are out there doing cold calls and pressuring people into signing? I think the hearings needs to address that. And some of what we've been talking about I think really helps that.

For example, disclosures about prepayment penalties. Good subprime lenders already do that. Bad subprime lenders don't. If you force everybody to do that, that gives the good ones a leg up on their competitors. Same thing with adjustable-rate mortgage disclosures.

And I also think the same thing is true for assignee liability. If you have a good lender, they're not as worried about it because they're putting out a good product. It's the really bad lenders who want to have the cut off of liability because they want to sell their loans and it's a lot harder to do that if the investors say, "Well, wait a minute. I could get stuck with a bad loan, you could go bankrupt and then I'd have to deal with the borrower."

So I think in all these areas the question is how do you design the rules to help the

good honest subprime lenders, which is what we all want.

MEMBER SEEBACH: Marva?

MEMBER WILLIAMS: There are two concerns that I hope that the hearings will address in addition to public policies to curb abusive practices. The first is implications of fair lending violations. As you all know, there are still significant unexplained differences and disparities of lending rates to African-Americans, Hispanics, and whites. And for quite some time consumer and community organizations have been concerned about the lack of transparency in the entire fair lending investigation and complaint process.

And I hope that at the hearing that there can be some exploration of how fair lending violations and their investigations can be disclosed in performance evaluations or in other public documents in a way that's fair to consumers, the lender and to community organizations.

In addition to that I also hope that in addition to talking about abusive practices so the hearings might also be an opportunity to talk about best practices. I think that there are some organizations, some institutions that are engaging in some very creative outreach in marketing and product development. And I think we need to hear more about that.

MEMBER SEEBACH: Thank you.

I'm going to do Alan, Lance and, Stella, did you want the last word or are you --

MEMBER ADAMS: Yes.

CHAIRPERSON SWANSON: Thank you, Mary Jane.

I wanted to go back a little bit to the point about consumers having all these choices in the mortgage market, particularly the subprime market and there are trade offs between penalties and adjustable rates and fixed rates. The difficulty is on the subprime side of the market that there's a complete absence of price transparency. The prime market if you look at your prices and your options, there's usually -- you know, one particular seller will have six or eight prices, you know, it's not that complicated and it's publicly advertised. And the difficulty in the subprime side is you have matrixes these require you to look at -- you know, one consumer can qualify potentially for a 100 different prices depending on the combination of loan features they're choosing. The consumer has no way to know that and it's the broker typically or the retail loan officer who knows what all the different pricing combinations are. And that's a problem to me not only with disclosure at the contract stage, which is how Truth in Lending works now; you get your disclosures at a point when you're pretty much committed, but it's also an issue with the advertising rules which I don't

think the Board has looked at in quite a while.

I don't think option 1 is required to advertise its prices. And there's really no way for me to know if I have a 500 FICO score and I want a 80 percent loan-to-value loan and I don't want a prepayment penalty or I do, you know where I'm going to fit on your chart. I mean, your broker knows and they know that if they bump it up a percent that they can get a premium and they know a lot of things about how that pricing works that is completely opaque, and that's the difficulty and to me one of the explanations for the persistence of price discrimination in this market is that pricing is not even choice to being transparent.

MEMBER SCHWARTZ: But maybe I could respond to that. Option 1 only buys loans from brokers, not direct to the consumer --

CHAIRPERSON SWANSON: Right.

MEMBER SCHWARTZ: -- and our rates sheets are publicly available. And also that's typical from the prime and the nonprime market. You often see wholesale rate sheets with those matrixes. But having spent my career in the prime market as well, that's very typical in prime, too. You see lots of matrices and broker pricing.

MEMBER SEEBACH: Lance?

MEMBER MORGAN: You know, I'm not in the banking business or mortgage business or anything, but I'm going to speak a little bit as a consumer. And, you know, I'm a business person and a lawyer and so I consider myself somewhat a sophisticated consumer. But when I buy, every time I buy a house, I'm sitting there and these disclosures are flying by and I'm just kind of signing them, you know. And I'm just kind of in a good mood, you know, until the part where they show the interest rates that you've got to pay over the life of the loan; that's the only thing that really jumps out at me. And I'm thinking about unsophisticated consumers and what they're doing.

And it really seems to me that it's a timing issue. When you're at the emotional moment and these papers are flying by and you're about to get your home, you know, these disclosures are really the wrong -- you know, they don't do much. You just kind of shake them off and go back smiling. And I think that if you're going to make an impact with these disclosures, you know adding more information and those kinds of things are helpful, but I really think it would be helpful if the timing changes so that it moved up the ladder a little bit in the process so it wasn't at the emotional time, at the closing time where this stuff is coming by and you're just kind of signing it

and you don't even really know what it is. And a sophisticated mortgage broker or whatever are very smooth in kind of handling those situations. So you've got to take some of the emotional aspect out of it and at a time when they'll still have a choice to go somewhere else.

MEMBER SEEBACH: Thank you.

Stella, the last word.

MEMBER ADAMS: That's a real good segue into what I wanted to say as the final word. I don't want to leave the hearing with no comments related to the consumer behavior studies. Because I think there is some importance to that. And then I hope this will segue into the nontraditional mortgage discussion.

But when we did testing two years ago a lot of our testers received information about what the payment was, not about the products themselves. Well, we can get you this payment. And one of the behaviors that I've come to see from consumers is they really think of when they go to a mortgage broker their belief is that that broker is working on their behalf; that there is some duty to tell them what's best for them. It's like going to a doctor and expecting the doctor to give you a diagnosis. And if the diagnosis is bad, then you might want a second opinion. But if the doctor says you're healthy, you're happy.

And what most consumers when they go to a mortgage broker think that he's giving them a financial health diagnosis. They are asking how much house can I afford. They are not asking about what products. You're the mortgage broker at a fully amortized 30-year fixed rate they can afford $171,000 house and you get your 2 percent commission off of that. Or at an arm interest-only loan they can afford a $250,000 house and you get your 2 percent commission off of that. When I come in innocently and ask you how much house can I afford, which answer are you going to get?

So it's not just consumer behavior, but also what is the motivating behavior behind the person who is giving the diagnosis. Are they looking at the health of that borrower or are they looking at the health of themselves? And so that has got to be part of the discussion when we look at the research around how we educate consumers.

And I love disclosures if they make sense and they're in plain language that says to me you are about to get in trouble. But if it's all lawyered up like the disclosures that come with the mortgage loans now, then it's a license for you to steal from me because I'm in the happy mood, too, and I'm just signing away my future without real knowledge and understanding.

And in North Carolina we used to have a rule that said that only -- that loans could only be closed by lawyers and that lawyer had a responsibility to explain everything to you. And the FTC said no, that was a monopoly. And now anybody can close a loan. And they don't necessarily -- there's nobody there who can necessarily explain to you what's going on with that. And they can tell you oh don't worry about that, you can refinance in a year. And you go okay, and you sign away.

So I think when we do the research piece we not only need to talk about the behavior of the consumer, we understand though that the consumer is going in wanting to fulfill a dream. And that is clouding their judgment, but they're depending on professionals in the mortgage market to tell them how much dream they can afford. And we need to analyze and do research around the behavior of the originators in the process as well.

MEMBER SEEBACH: Thanks, Stella.

The second area that the staff asked us to consider today was the nontraditional mortgage products, and especially the adequacy of existing regulations, Z disclosures and marketing requirements.

I believe generally that everyone on this Council thinks this is absolutely an appropriate topic for these hearings, but I'm going to defer discussion on that for our next much more robust discussion on nontraditional products. And at this point I'm going to go on to the third area, which is the HMDA data. Marva, the staff is always looking out for you.

The staff would like to us to inquire into the reasons for the racial and ethnic difference in the tendency of borrowers to obtain loans from certain lenders. The hope is that this discussion can help stimulate additional research and lead to new educational strategies. So basically we're looking at why certain channels, why certain lenders in certain markets.

Anyone like to offer comments on whether or not that's an appropriate topic for the -- there you go, Stella.

MEMBER ADAMS: I hate to monopolize it, but it is absolutely an appropriate topic to be discussed.

We need to look at whether or not there are statistical rationales for the big gap in the type of housing. We need to figure out what is the problem and fix it. There is -- if we find -- the research is critical so that we can identify where the problems are. They're affecting home ownership rates, effecting pricing of loans to African-American and Hispanic families so that we can

fix it and level the playing field. And it can't be done by just saying well we adjusted for it and that eliminated a lot of the disparity.

So that we need to find out well if it's credit scores, then we need to work on how we improve those for African-American and Latino borrowers. If we find that it's debt-to-income ratios, then we need to say are we setting them at the right spot. We need to make sure that we not just use the data to run away from the issue, but we find a way to resolve the issue and make home ownership and make access to the American dream an equal opportunity dream for everyone. But we also have to acknowledge the history of public policy choices that have put these communities behind the eight ball, so to speak.

MEMBER SEEBACH: Kurt?

MEMBER EGGERT: I completely agree with what Stella says. I just want to add a small piece.

When we're talking about the HMDA data, I think it's also important for the hearings to discuss what more can we do, what more information can we obtain to gain new insights. I mean, I think we've seen an explosion of interest because of the new data we got this last time around, but there's still a lot more that we can get.

For example, we can get a lot more information on the age of borrowers. I've looked at a lot on our lending industries, is there a problem with older borrowers? And there's a lot of anecdotal evidence, but I think that there's a lot more information that can be gathered.

We could also look at trying to gather information about FICO scores, loan-to-value, debt-to-income ratios. And that would help us really zero in on is the disparately, can it be explained by good lending decisions or do we have a real problem here that we have to do everything we can to address?

MEMBER SEEBACH: Faith?

MEMBER SCHWARTZ: I absolutely support having HMDA hearings. And I think as Stella said, some of the reports even the Fed reports some control risk had narrowed the gap of interest rate spread in the high risk bucket or the high spread bucket. But it feels to me like if we embrace this and just figure out how to eliminate that spread, regardless of the controlled reason it's already narrowed, if that's the dialogue we should be having at these hearings. So it's a combination of tools in our arsenal to narrow any gaps in lending that do exist. So I'm very supportive of having them.

MEMBER SEEBACH: Alan?

MEMBER WHITE: I think that there will be a lot of overlap, actually, between some of the subjects we've already disclosed about transparency and about channels and how the market gets segmented and this price discrimination problem. And, you know, I think the Fed study was extremely valuable in telling us that you have really a lender discrimination problem and a market discrimination problem. You have to some extent lenders with unexplained price disparities between their minority customers and their white customers. But a more significant part of the problem is the disparity in the market that minority borrowers are buying mortgages at higher prices from lenders who specialize in making high prices loans.

Normally you would think as an economist that the market would fix that simply because lower cost lenders would seek out these people who are paying excess prices and market to them. And that doesn't happen, and it's been a very persistent phenomenon in subprime market for quite a long time that you have these huge dispersion of prices and now because of HMDA we know that we know that it has this disparate racial effect, which is very troubling.

So I think when we talk about lender discrimination, obviously the enforcement tools are all understood and you can certainly debate exactly how you measure that and how you analyze a lender's practice, but I think you also -- it's going to be very important to look at the mechanisms in the market that aren't working for the market to correct the discrimination between and among lenders.

MEMBER SEEBACH: Tony?

MEMBER BROWN: I, too, support hearing on this regard and I think staff is absolutely correct that the discussions, the hearings will bring and stimulate hopefully additional research and lead to consumer education strategies. I know it's going to give the lenders some degree of anguish as when HMDA talked about the denial rates by race and it lead to financial literacy discussions around credit history and debt relative to income. And I think that once we start talking about the pricing disparities, I think it'll do the same thing. And it relates to the conversation we had earlier. There is a difference in how a loan is priced relative to which channel you go through for funding. And that there is overlap. That a borrow who qualifies for a prime loan perhaps went to a subprime shop and is getting a subprime loan, where they could have qualified for a prime loan. And I'm hopeful that these discussions will add to increased borrow education and that it will also highlight and identify fair lending issues for those institutions who are doing it wrong. So I think

that would be a positive income and I think it's worthy of a hearing discussion.

MEMBER SEEBACH: Don?

MEMBER CURRIE: Just one follow up what Alan said before and a little bit about Tony.

I think one of the interesting points is looking at the whole research area and the difference of how African-Americans and Hispanics borrow versus whites and Asians and how they borrow and what's important to them. For example, in the Hispanic market paying off your mortgage loan quickly is an attribute that's very valued. To penalize somebody for doing that is, you know, something that everybody strives for, wants to do and to be penalized for that kind of incentive is a little bit ridiculous.

But in terms of the marketing I think one of the issues I would like to see and kind of focusing on faith is to basically look at how subprime lenders do their marketing and why is their marketing so successful in low-income communities? Because it is obviously is very successful. And why is not the marketing of the major banking institutions or prime lending institutions, why does it not penetrate the market in the same way as marketing for, you know, a reputable subprime lender as they penetrate the marketplace? And what regulations might be out there that actually prevent a prime lender from more actively marketing product into that marketplace?

We had an experience with one of the major secondary marketplayers in trying to deal with foreclosure issues. And one of their concerns is well in even going after trying to repair loans that were in need of refinancing, I mean one of their major issues was they didn't want to aggressively go to the borrower and appear to be a kind of a subprime lender. Legally they felt that they just didn't want to market themselves as going aggressively after that borrower, even to help them out of the situation that they found themselves in.

So one of the things I think the hearings can promote is not just making the market more one, which I think Faith is basically talking about, a prime and nonprime market basically converging, but also looking at what makes those institutions so successful at attracting those borrowers outside of price and are there any regulations that basically prevent those that are participating in the prime market from competing in that same way?

MEMBER SEEBACH: Anything else on this piece?

MEMBER ALGIERE: I just want to make a comment on that, Don. And I don't disagree with your comments, but one reason for my opinion, one reason that comes to mind is the

bad guys are out there. The don't have to follow the same rules we do as banks. We have rules pertaining to advertising, rules to way we conduct our business. And some of those folks that are out there, and I'm just guessing right now, do not have to follow the same rules we do.

MEMBER CURRIE: And my point is are some of those rules inhibiting?

MEMBER ALGIERE: Well, and that goes right back to what Kurt said earlier. We have to be very careful what we do. We don't want to make things so difficult that the good guys, and I use that term generally and loosely, that we can't conduct business or the good guys can't conduct their business and the bad guys are going to still be out there doing what they shouldn't be doing.

MEMBER CURRIE: So what might be those regulatory barriers that would prevent you from entering that marketplace?

MEMBER ALGIERE: Again, it's generally speaking. I can't get specific.

MEMBER SEEBACH: All right. Thank you.

Yes, Sheila?

MEMBER CANAVAN: Just one comment. I may not just be removing regulatory barriers. I mean some of the practices I've seen in Mississippi actually I've mentioned before. But I know that some unsavory characters choose to seduce ministers, police officers, supervisors in places where they know people work like chick plants and encourage them to send customers to them for loans and pay them for that.

Now I don't think that's -- I mean, how do you get at that problem? I mean maybe that is going back to what we were talking about in terms of airing how markets work at the hearings. Because, you know, lenders need to hear this, too. I mean, what are the barriers or what can you do to encourage legitimate approaches to people who are likely to have some influence in their community in terms of getting to banks?

MEMBER SEEBACH: Thank you.

I'm going to go on to our last topic, which is reverse mortgages, a product for which demand is going to increase significantly in the next few years as I get closer and closer to that age.

Ninety percent of all reverse mortgages are currently the HUD home-equity conversion mortgage, but that's going to change as new lenders offer their own version of the product. It would be very interesting to hear from members of the Council who are familiar with the

HUD product on the sufficiency of current disclosures and counseling. And then also to talk about what disclosures and other obligations, for example counseling requirements, should be considered by the Board as this product becomes much more prevalent.

Alan?

MEMBER WHITE: Yes. Reverse mortgage product is one I actually had a number of clients use, often to get out of a bad loan, particularly a predatory mortgage that we've renegotiated. And the key to me of why the FHA program is so effective, it's a complex product and it has the features of insurance as well as a loan and for an unsophisticated consumer, there are tremendous risks that they might not understand.

The way that HUD has protected consumers that I think has been effective is to require counseling. In order to get one of these FHA reverse mortgages the elderly homeowner has to go to an approved counselor and receive advice from a person who is not getting, obviously, any commission or have a financial incentive in the transaction. They get, hopefully, neutral advice. And I've found that to be very effective and counselors in Philadelphia refer people to me if they're trying to refinance out of a bad loan, and I refer consumers to the counselors who use that FHA program.

I am certainly concerned about the extent to which there is going to be private products that don't involve counseling that start to grow and develop, because it’s such a complex product that the issue of transparency and consumer understanding is a very daunting one.

MEMBER SEEBACH: Thank you.

Dennis?

MEMBER ALGIERE: I agree with Alan. I think we need testimony from those who are offering the product and do it well, and counseling is an important component of that; people to understand what they're getting into. So I do agree with Alan on that. I'd like to hear testimony from those who offer the type of counseling that's approved and some stories on how it's worked and ensuring that the consumer, the customer fully understands what he or she is getting themselves into.

MEMBER SEEBACH: Thanks, Dennis.

Kelly?

MEMBER WALSH: With respect to the views of my fellow Committee members who I know feel strongly about reverse mortgages and the need for testimony on that, I

would recommend that you consider not using part of the hearing process to collect information about reverse mortgages at this point.

I think that there is so much information that's needed about the other topics, predatory lending and nontraditional products and HMDA data and it's such a rare opportunity for you to have hearings, and you have other mechanisms for gathering data on reverse mortgages. The research function of the Fed, the Community Affairs Officers and certainly there are ways to identify those providing reverse mortgages and collect their thoughts. And those who are concerned about reverse mortgages and to collect their thoughts. I think that the hearing process should be really used more specifically and narrowly at this point to collect information about what we're most concerned about, which is really the nontraditional mortgage products and the predatory lending risks.

MEMBER SEEBACH: Thanks, Kelly.

Anne?

MEMBER DIEDRICK: Kelly just eloquently said exactly what I was going to say: The issues on predatory and nontraditional should be the focus of the hearings. Reverse mortgage could fit into a nontraditional product discussion, but it is such a peanut in the scheme of what we're talking about, that I would hate to see a whole panel spent talking about reverse mortgage product.

MEMBER SEEBACH: You guys cut me to the core. This whole peanut is going to grow into a big old grove and then everybody's going to say why we didn't have a requirement for disclosures and counseling. Mary Jane told you.

Anybody else want to talk about? Kurt?

MEMBER EGGERT: I just wanted to weigh in on your side, Mary Jane.

MEMBER SEEBACH: Thank you, Kurt.

MEMBER EGGERT: I think ten years from now we're going to see a huge growth in reverse mortgages. And it is a very complex product and not many people understand it. I know because one of my hats is running an elder law clinic and I have elderly clients who are stuck in one and sometimes it's good and sometimes it isn't. And it's a great product for some people, but there are significant potential pitfalls. And I think that it's important for the Fed to understand what's going on with reverse mortgages, what those pitfalls are, and try to figure out how to disclose it and get ahead of the curve on that before the market grows around it without its guidance.

I agree that it's not as significant as a lot of the other topics that we're discussing,

and so I wouldn't dominate a day or have it at every hearing. But I think there should be at least a portion of some panel somewhere that talks about it, has to address it and has Mary Jane on the panel.

MEMBER SEEBACH: All right. Anybody else on reverse mortgages?

Thank you, Kurt.

All right. So then I open it up. Are there any other issues that we haven't highlighted that we think might be appropriate for the Board staff to consider as they put together the announcement for these panels? Any other issues that we think? Carolyn?

MEMBER CARTER: This may not be quite a responsive answer, but I think that the sort of robust and wide ranging discussion we've had over this past hour illustrates my first point: That the real goals for the hearing are to have a broad-based discussion of the problems in the home equity mortgage lending market and what can the Fed do? If there are things the Fed can't do, what should the Fed call on other players to do?

And so I just go back to my initial point about the goals for the hearing not to be overly cautious in expressing those goals.

MEMBER SEEBACH: Thanks, Carolyn.

Anyone else? Kurt?

MEMBER EGGERT: One of the things I do is track different settlement agreements against lenders and note how they change over time. And one of the most recent big settlements, a lot of the focus was on abusive appraisals. And we've seen this around the country of borrowers purchasing a loan or refinancing a loan and having the loan appraise at perhaps significantly more than the house is worth.

Now reaction of lenders is, well, why would lenders want to do that because their over-appraising property can't possibly help the lender. But it is a significant problem. And it hurts borrowers in that borrowers may get into a loan buying a house that they think is worth X amount and then if they get into problems, they find out that it's worth a lot less. And if they run into payment problems, suddenly they're stuck with a house that's worth less than they've borrowed on it. So it can hurt borrowers.

But I think this sort of appraisal problem is something that the hearings should address.

MEMBER SEEBACH: Tony?

MEMBER BROWN: Though we did talk about HMDA data and the pricing information, the importance of the hearings, there's some other things that I hope that the regulators are doing with their financial institutions that as they're looking at some of the HMDA data that they're consulting and encouraging the financial institutions to make the type systems investments where they can look at FICO score, loan values and try to isolate where there are problems by race and higher-priced loans. And then the type of systems enhancements where they could even track deeper as to who originated those loans if they were purchased or originated so that if there is a pattern, that they can stop doing business with the broker or they could provide the appropriate training or terms and conditions in their legal documents that will allow for a better practice, using Stella's analog that the changes in HMDA now provided a way to diagnose that I have a symptom and there's a problem and they have to dig deeper. And that if they dig deeper, they find out that there is a problem, that there is a pattern as opposed to the hearings where we're likely to get spin and sound bytes, but the real work has to be done relative to what the management and the regulators do about finding problems and fixing them.

MEMBER SEEBACH: All right. Thank you, everyone.

We do look forward to these hearings. I think it's always a meaningful exercise for the Board to go through this. And any help we can give in helping to structure what's going to be discussed, we're always available.

Thank you.

CHAIRPERSON SWANSON: Okay. Thank you. Great. Great discussion.

The next topic relates to nontraditional mortgage products. And in that regard the Federal Financial Regulatory agency has issued a proposed guidance on residential mortgage products that allow borrowers to defer repayment of principal and sometimes interest products, including interest-only loans and payment option adjustable-rate mortgage loans.

Members of the Consumer Credit Committee discussed both the proposed guidance and the potential impacts on consumers and the financial services industry, and as well members of both Consumer Credit and Community Affairs and Housing Committee discussed this subject as a potential topic for the home-equity lending hearings, as Mary Jane mentioned.

So with that, I'd like to turn it over to Kurt Eggert, the Consumer Credit Committee Chair who will lead the discussion on this topic.

MEMBER EGGERT: Thank you.

There has been a huge growth in what has been called nontraditional loans. The traditional loans being the amortized fixed period loans specifically 15 to 39 years. Nontraditional loans include adjustable-rate loans but also interest only loans, payment option loans. And what these do is they provide borrowers with payment flexibility and with lower initial payments.

We also other somewhat nontraditional loans such as no-doc or low-doc loans which allow people who either can't or don't want to fully document their income to get loans.

While these have very useful properties, there are two problematic aspects. One is whether they threaten the safety and soundness of financial institutions, which is not quite in our bailiwick. More to the point is whether they present consumer protection concerns that have not been addressed by rules designed to govern traditional loans.

Now in a way these two aspects are related, though, because the same thing that might threaten the safety and soundness of a financial institution might also a borrower in that if a loan goes to foreclosure it can hurt both the institution and the borrower.

So the question facing the Council or that the Council was looking to address is what aspects of the rules governing loan origination should be changed regarding nontraditional loans? Should there be any sort of special rules or special ways to address these nontraditional loans?

And another question is do borrowers currently understand the risk of these loans and if not, what can we do to help make sure that they understand them?

Nontraditional loans create a risk both of payment shock when the loan payment goes up, and negative amortization. And so the question is, is this risk fully disclosed to borrowers and if not, how can we do so?

So the first question is who are the players in nontraditional mortgages and why is this segment of the industry growing so fast.

So I'd like to turn to Faith.

MEMBER SCHWARTZ: I got nominated to speak to this yesterday.

Well, as we were having a very robust discussion about these markets yesterday, we got a little bit grounded that it exploded almost over night; interest-only and option ARMs, which I don't know a lot about option ARMs so I think some other people here do, some lenders who offer them. So before you get into it, you have to wonder, well, what in the world happened in the last 18 months to have an explosion of interest only across the mortgage sector, and I'd like to

really bring that into play. Because interest only has sprung into both the prime market, it's very dominant in the Alt A market and then it has crept into in the nonprime market. Interestingly enough, it's subsided quite a bit, so it's been a very volatile entrance and kind of have phased out a little bit because pricing and risk and metric have kind of adjusted that explosion of market to where it's not as attractive as a borrower.

I'd like to separate. I think the Fed has to be careful when they throw option ARMs in with negative arm products and with an interest only. Again, Option 1 doesn't do option ARMs and I'm not familiar with how they operate, really. But both products have been around for a long time. And I think it's important to note there must be a driver, and it can't be all push marketing in the whole market segment because it's exploded. So what is the cause of that?

And if you look closely at the demographics of what's happened, you see the market has predominately been in the coastal areas in the places where income has not kept up with housing prices. So California is a pretty dominant state for just about any exotic ARM or interest only that you've ever seen. And I've been in the lending market far too long, about 23 years, but the east coast never sees that stuff until it's all happened in the West Coast and it comes east. And that is how the markets work.

So when you ask who is in this market for interest only, I would suggest most every lender in the country is in it, in one way or another. Maybe not some. I think some yesterday said they had no designs on offering it.

But I think the affordable issue is a big issue, and it won't go away. And so as the Fed does its rulemaking and discusses this, I do urge them to be careful about the innovation of what markets do and respond to industry issues, consumer issues but also temper it and let institutions do their risk-based layering that they've been doing for years, whether it's a bank or a nonbank. People have to perform and offer good loans and keep people in the homes.

So I don't know if that answered your question, but it does impact all the market, not just subprime or Alt A and prime.

Does that help?

MEMBER EGGERT: Thank you.

Anne?

MEMBER DIEDRICK: Thanks, Kurt.

Chase does not offer negative amortization products so any comments I make this

morning would just be focused on interest-only product characteristics.

I think you asked about who the applicability of the proposed guidance. And at Chase we believe that all mortgage lenders should be made subject to the underwriting disclosure provisions of the proposed guidance, not just federally chartered lenders. Limiting the scope only to federally chartered lenders would place these lenders in extreme competitive disadvantage. Nonfederally chartered lenders would be free to continue to offer nontraditional mortgages without the consumer protection and regulatory burdens imposed by the proposed guidance.

The unintended end result may be fewer federally regulated lenders offering nontraditional mortgage products and fewer brokers and correspondent lenders selling into federally regulated lenders.

The overall effect on consumers and the housing industry would be negative, and may even serve to destabilize certain geographies that may be heavily weighted toward nontraditional mortgage products, as Faith just mentioned.

Extending the reach of the proposed guidance to all mortgage lenders would be accomplished to a great extent through modification of existing federal disclosure laws and regulations that apply to all mortgage lenders such as Truth in Lending Act and the implementing TILA regulation.

Chase welcomes the opportunity to join with other industry lenders to participate in a review process to ensure that TILA properly reflects today's mortgage marketplace.

MEMBER EGGERT: One of the issues is, as Stella was talking about earlier, often times people get loans not because they've sought out a particular product, but because their broker has encouraged them to take the product. So one of the possibilities of this loan is, I guess the question is are brokers putting people into these loans and is there something that we should do to regulate the brokers? And, Sheila?

MEMBER CANAVAN: Yes. Actually, I would like to share a personal experience. I'm a consumer fraud lawyer, as most people know, but I recently took out a loan in Utah and went to a broker. And I can tell you even though I know a lot about this area, I still don't know what kind of a loan I got, and I'll tell you why.

I could tell by the way the broker was interacting with me that the broker was heading in the direction of giving me a non-doc or a low-doc loan, and I know that those loans are more expensive. And so I spent a lot of time saying "Now wait a minute. No. I've got plenty of

documentation here." And then I guess that's enough on that point.

I just want to say that once I got my loan, I'm still not sure whether I paid a higher rate and have a non-doc or a low-doc loan. And I think that there are incentives in the marketplace and some of them are monetary and some of them rate to time. For example, a broker knows that they can get a loan approved a lot quicker if it's a no-doc or a low-doc loan. They also are compensated higher and so the lenders who sent those loans into the marketplace.

So consumers, though, don't necessarily know that because for example, you will be asked to provide all kinds of documentation if you have it available because of the secondary market. The investors want that information if it's available. But I think it's very difficult. Consumers don't know what kind of a product is available to them when they go into a broker or a lender, and they don't know what product they come out with. And I think that's important that they should know those things.

MEMBER EGGERT: Stella?

MEMBER ADAMS: As you all know, this has been a scary topic for me for two, three years. And I think I've been Chicken Little saying "The sky falling." But it's really coming soon, to my great fear.

I think I'm particularly worried about these products have in fact been around forever, most of the products that we're talking about. But they were mainly niche products for specific people. Until recently they didn't account for five percent of the total mortgage market. And now in some markets on the coastal areas they're as much as 60 percent of the market. They have expanded well beyond their product intent.

So I'm not supporting getting rid of the product, but rather looking at the suitability of the product for the sectors in which it's occurring. When you're talking about a trillion and a half dollars worth of this resetting in an environment where there's a softening of the housing market, the average housing price has dropped, not a lot, but it's dropped in the last quarter. And if that continues because of interest rate increases, flattening of yields, that's going to put pressure on the housing market in a way that may once these foreclosures and these resets happen, it may precipitate a downward spiral that starts on the coast and then creates panic in the east that could have implications on our total economy as well. But anything that give a sneeze to the macro economy is pneumonia in the micro economy in my neighborhoods. And we're already seeing foreclosures increase. I'm already seeing folks I've never seen before, middle-class and upper-

middle-class folks coming into my office as the adjustable rates getting beyond their income capacity. And when folks are looking to sell, they find out that they don't quite have the appreciation that they thought they would have to be able to get out of the loans.

And North Carolina's housing market is going at 20 percent or 30 percent like in some other markets. It's more at your traditional five percent to ten percent a year. And when you do a 100 percent interest-only loan or piggyback loan layered with option payments, it is really problematic for folks to get out. And we really ought to talk about the layering. I could go on nauseam, but I'll leave that for my comments.

MEMBER EGGERT: Okay. Mary Jane and then Faith.

MEMBER SEEBACH: I was just going to comment that it's important to remember that in a broker deal, the broker owns the relationship with the borrower, they have all the interaction with the borrower. The lenders provide the required disclosures directly through to the broker to give to their client. So to the extent that especially the Reg Z is amended to more specifically detail particular elements of these transactions that will be clearer for the borrower, that's the information that the lender is pushing through to the broker. But, again, it's the broker who owns a relationship between, that brings the borrower to the lender. It's not until after the loan closes that you actually begin a relationship with the borrower.

So the better the information and the more standardized the information is through the market about these products, the better it is going to be for consumer who hopefully won't be able to go from one lender to another lender and get different information or lack of information about the particular product.

MEMBER EGGERT: Okay. Faith?

MEMBER ANDERSON: I'd just like to add that a lot of smaller financial institutions don't offer these types of loans yet. And so when I first learned about them last year, it was very helpful to see a chart of the pros and cons of the various types of loans where they compared a 15-year to a 30-year to a negative ARM, to a option ARM and just to see well this is the benefit if you know that your income will increase in five years, you may want this type of loan. And I think it would be helpful to a consumer if they had a chart where they could actually see what the pros and benefits are of each type of loan. And also, so that it's made an easy to understand language.

And just to reiterate what Anne had also said and some of the folks, is you want to

make sure that mortgage brokers or you get the whole industry that offers these types of loans to make the disclosure. Because the financial institutions that are federally chartered or state chartered are required to give certain types of disclosures. And it you should get to the meat of or the issue of the problem.

MEMBER EGGERT: Okay. Dorothy?

MEMBER BRIDGES: I read somewhere a while back that it is very, very difficult to legislate morality and ethics. And that for the most part I think we have very good people in our industry that are doing the right things, and some of these nontraditional mortgages really allow them to really offer credit to people and expand the area that they offer credit in nontraditional means to good people. So it's good lenders doing the right thing and helping good people.

In terms of the nontraditional mortgages, I just wanted to make sure that as we're looking at this guidance that we ensure that it's limited to those nontraditional mortgages that are predatory and that are not working, but we don't put any prescriptives on the way that you underwrite and legislate these things that you're brushing all of the products with the same brush stroke and thereby limiting the capabilities of those good lenders to really, really deliver the products to the consumers.

The second thing in terms of these nontraditional mortgage products, and this is coming from a banker who has absolutely nothing to do with mortgage lending, but in terms of delivering a product that works for our consumers.

The second thing is the education piece of it that I think it has to be a dual approach. Number one, the education from the lenders talking about product specific kinds of things. But number two, consumers in helping them understand that they have choice.

And you may very well find that some consumers will say I don't care. It's just like going to the car dealership and buying a car. They, for the most part, are not concerned with what at the end of the term you would have paid in interest. What they're looking for is what my monthly payment. So educating the consumer to understand that while you're looking at the present, in the future it is very, very important you understand that paying $50,000 on a $15,000 is just not the way business is done, and this is what it's going to cost you. So looking at more than just the monthly payment. So somehow someway we have to be proactive in helping the customer think about things differently so that their behavior changes.

More specifically in the guidance I do know that there are some things that are

conflictual in nature in terms of products that are there for the industry that's worked for a number of years. And, again, I apologize for my ignorance in terms of the percentage of those individuals that abuse those traditional products as the traditional ARM and it's been absolutely helpful. The stress testing that's been mandated by these guidance I think is somewhat troublesome for the industry in that there's going to be a very difficult selling point for traditional lenders to look at stress test mandates that says you have to stress test this thing for 30 years when the industry itself has a history of much shorter terms.

And so we have to be very careful that the guidance that we put in place really, really works for the right reason, but also work so that there are not these predatory instances and issues in that this guidance covers not just traditional lenders but everyone that's in the industry.

MEMBER EGGERT: Thank you.

Mark and then Marva.

MEMBER METZ: Following on some earlier points, I think these products are there. I think in and of themselves they're not bad. Where they get into trouble is when they're steered or sent to the wrong people.

A comment was made about suitability, as a lender that's very concerning. I think lenders can't police the borrowers. I think what we do and we talk about is let's make sure that borrowers understand what they're getting. Again, we are very much in favor of full and fair disclosures and as Kurt mentioned, the good lenders already do that.

I think as follow up on a point that Anna made to the extent we can apply -- and I'm not sure we need additional regulations. I think we may need amendments of existing regulations, maybe amending Reg Z so that it applies to all lenders so that the sort of good lenders and the bad lenders all should play by the same field and that people do understand what they're getting and where they end up.

MEMBER EGGERT: Marva?

MEMBER WILLIAMS: I just want to reiterate concerns about nontraditional products and particularly because these products are not being marketed primarily or just in a more affluent highly appreciating markets, but they're now being marketed and made in other communities and in particular to lower income consumers.

The Woodstock Institute and several other consumer and community organizations, members of the CAC are members of the National Coalition for Community

Reinvestment. And CCRC has developed some very thoughtful comments on nontraditional loans. And I'd like to just reiterate a couple of points that they've made here.

The first is that when negative amortization occurs, this is very problematic for consumers and minimum payments can lead to that. And we believe the lender should approach these, the underwriting of these loans, with extreme caution. And that perhaps one way of dealing with this would be to develop a cap in terms of the amount that can be negatively amortized that is someway indexed to the original principal amount.

Our other concern is combining stated income loans with traditional -- or nontraditional products can also be very challenging for consumers. And it also, I think, opens up opportunities for fraud and overestimating borrower's income, which can be a big problem. And the need I think in these cases to look not only at credit scores but other kinds of factors when underwriting these loans.

And then last in terms of consideration of future events, we're very concerned about what will happen when interest rates rise, as many other people have also expressed concerns for that. And that it's important to estimate projections in future interest rates and to present to the consumer the worst case scenario and so that they can gauge whether the future payments will be affordable to them.

MEMBER EGGERT: Thank you.

Forrest?

MEMBER STANLEY: One of the things that we've discussed throughout the committees since I've been on them on is meaningful disclosures. I don't think there's any doubt that the recommended practices that are in the guidance are very meaningful. But I think there's a real concern about information overload. And one of the advantages of putting it into Truth in Lending is that we can get, hopefully, a cohesive disclosure as opposed to just having another piece of paper in addition to the Truth in Lending disclosures that's handed out at closing. And even the most sophisticated lenders, as Sheila indicated, can be -- it's just hard to parse your way through all of that.

So I'd just reiterate, I also am very much in favor of putting it in Truth in Lending. And as I said, I think one of the added benefits of that in addition to leveling the playing field, will hopefully will be a more meaningful disclosure that everybody can understand and use.

MEMBER EGGERT: Carolyn?

MEMBER CARTER: I'm going to say something similar. I was really glad to see

that the guidance addressed the issue of the worse case scenario disclosure. The guidance says that product descriptions could specifically state the maximum monthly payment a consumer would be required to pay if the interest rate went up to the cap. I think that disclosing the cap is very important, not just for the consumer but also by disclosing the cap, that's likely it shines a light on the interest rate cap and probably would create some downward pressure on that cap so as lenders tried to make their product look attractive to consumers and be attractive to consumers. So I'm very glad to see that the guidance addresses this issue, but I think that the guidance does not go far enough.

First, the guidance only relates to nontraditional mortgages, and as I said earlier, the problem of nondisclosure of the worst case scenario applies to all ARMs, not just exotic ARMs.

Second, the guidance doesn't say that any lender has to make this disclosure. It says the lender could specifically state the maximum, could clearly describe when structural payment changes will occur. It shouldn't be "could," it shouldn't be "should," it should be "must."

Third, even if all the lenders did it the guidance doesn't say how to do it. And lender A may do it in a clearer more prominent way than lender B, just by happenstance. And it will be up to each institution to figure out how to do that. That will make it harder for consumers to compare. They will be comparing instead of apples-to-apples, apples-to-grapes, apples-to-prunes. And it creates a full employment bill for bank lawyers each of whom has to devise a separate way of disclosing these things that ought to be disclosed.

I know that flexibility is favored sometimes, but this is not an instance where there should be flexibility.

And finally, the guidance doesn't go far enough because the guidance is not universal. It only applies to entities that are regulated by the specific federal banking regulators, not to all mortgage lenders. And that could create a competitive disadvantage for the lenders who will abide by the guidance.

At the Consumer Credit Committee meeting in October we discussed this and we also had a very similar discussion yesterday. In October the lenders all said that they do not give the worst case scenario disclosures now because they believe it would scare away customers. They also all said that if they had to make those disclosures, they believe they could compete just fine but that no one's going to make them unless everyone has to make them, and it can't be best practices, it has to be mandatory.

So I hate to be beating on the same drum but, again, I urge the Board to consider amending Regulation Z to require these disclosures rather than just make them predatory as in this guidance.

And Lance raised the issue of timing. I think that the timing of disclosures is another great weakness in Reg Z. You currently have a rule about estimated disclosures that are supposed to be given in advance. There are three problems with that. One is timing, one is accuracy and another is enforceability. I think that not just for nontraditional mortgages, but for all mortgage lending the estimated disclosures need a hard look and need a whole lot of improvement.

MEMBER EGGERT: Thank you, Carolyn.

I believe at our Subcommittee meeting yesterday we had a rare instance of unanimity, and anyone correct me if I'm wrong. But everyone sitting around the table agreed that the kind of disclosures regarding adjustable-rate mortgages should be mandatory in Reg Z and that the Board should provide guidance on how those disclosures should be made.

And so if anyone doesn't agree with that, please raise your hand and I'll be happy to call on you. But it was such a shocking instance of unanimity that actually they had to pour a bucket of cold water on me to wake me back up.

Alan?

MEMBER WHITE: I think, Anna, were you going to disagree with that?

MEMBER RENTSCHLER: No, I wasn't going to disagree with it. However, I would state that on the disclosure end, and I think it is very important that we do disclosure to our borrowers what they are getting into, however I would caution the Board to take a good look at the disclosures and not just tweak it around the edges. It's a costly and often time consuming thing to redo the disclosures on an ongoing basis. And if we do it every time we turn around, it gets to be very costly.

So I would encourage you to take a good hard look at all the facets of the disclosures and how they're delivered.

On the one side from a community bank standpoint, and I've been in the mortgage business and a direct lender for 15 years, I would disagree with Carolyn. And I'm speaking on behalf of the community bankers. I don't think there was a time when I had an ARM loan that I didn't take the time to say this is the worst case scenario and this is the most that you could possibly pay. Of course, not adding in the escrows that are beyond the lender's control. So I think it's important to

recognize that there are good lenders in the market, that we do take the time. And we in community banks often serve as counselors to our borrowers and we are not just lenders. And I did not get paid on a commission basis.

I also live in a small enough community, and in the midwest we are a little bit different than the East and the West Coast, that I am going to run into my borrowers in the grocery store, on the streets. And I have to look them in the eye and be able to talk to them and hopefully they will be return borrowers. So I don't want to lead them astray. So I think it's very important to note that there are some good players in the market and we do try our best.

As far as disclosures, we do make them at the front end. However, I've had discussions with people across the United States that do not think that these rules apply to them, where in fact I would argue that they should be giving the proper Truth in Lending disclosures and they think it doesn't apply to them, so they just move on down the road.

Often times the brokers might fall into this bailiwick or their big projects that they're trying to put together, and they would be the lender and then they would take the money and go on down the road.

So I think it is important that we do have consistent disclosures across all lending markets regardless if you are affiliated with a financial institution or a broker selling upstream to the large GSEs or others.

MEMBER EGGERT: Thank you.

Alan and then Stella?

MEMBER WHITE: I do want to support what's been said about this, but at the same time get back to the other issues about nontraditional mortgage products, I don't think -- although improving the disclosures is an important thing to do, that that is going to solve the problem that exists that the market basically has been underwriting less and less. And we've seen, for example, debt-to-income ratios go from 35 percent to 40 percent to 45 percent to many subprime lenders will now lend at 50, 55, 60 percent of income. And these nontraditional products are layered with a lot of other risks that are created, such as having no-doc loans.

I do want to commend the Board and the other agencies for having put out the guidance. I think, as Carolyn knows, that it could it be stronger in some respects. I also share Anne's concern that having a guidance that applies to depository institutions when most of the market consists of nondepositories that are funded by the bond market is troublesome. And maybe there's a

way to make it a more universal guidance. But I think it is very important for the federal agencies to provide substantive guidance on these risky products. I don't think we should assume that the people who design the products, which I think to large extent are people in bond rating agencies and Wall Street underwriting firms, necessarily have sorted out all the potential risks over the long term. We just don't have the experience to really be able to do that. I think that having some guidance about limiting risk and having real underwriting is a very important and useful thing.

I think the other missing piece is this agency problem with brokers and that some of these nontraditional products are being sold to people for whom they are not appropriate. And one of the measures that's been suggested, and I think that really ought to be discussed, is creating duties on the brokers who sell these to sell suitable products in the same way that stock brokers have to provide suitable investment advice and suitable investments for their customers, and insurance sales people have the same duties; mortgage brokers under the current patchwork of state laws have little or no duty to their customers. It varies from state-to-state, but it is often the case that a broker gives the consumer a document that says I have no loyalty to you. I am getting a fee. I'm not going to tell you how much the fee will be. You'll find that out later at closing. And I have no obligation to get you the best or the most appropriate product, and I certainly don't intend to do that. I mean, it doesn't quite say that. But some of the forms that I've seen of the broker contracts are not that far from saying that sort of thing.

And, you know, obviously there's some issues as to where in the regulatory scheme that kind of suitability standard can be imposed. And I realize that it's not exactly within the bailiwick of the Federal Reserve, but it's still a very important component and I don't think disclosure solves the problem. If you're providing disclosures, even perfect disclosures in a timely way but you still have this broker/consumer relationship that's not regulated.

MEMBER EGGERT: Okay. Stella and then Sheila?

MEMBER ADAMS: I'm not a lawyer, but if I'm wrong on this, Truth in Lending doesn't apply to brokers, is that right?

DIRECTOR BRAUNSTEIN: Truth in Lending applies to all lenders. The brokers aren't --

MEMBER ADAMS: The brokers aren't lending.

DIRECTOR BRAUNSTEIN: They still have to give -- well, whoever is closing the loan has to give the disclosures.

MEMBER ADAMS: They have to give the disclosures, yes, but they're not covered in terms of -- if they don't give the disclosures, it's the lender who is in trouble not the broker, right? And the suitability -- I don't know that it is critically important that these rules and regs on nontraditional mortgage be imposed on all lenders. But it's also incumbent on us to recognize that when Truth in Lending was passed, the majority of loans were originated by lenders inside their own shops. And it was not done by brokers. That brokers when Truth in Lending was passed were not 70 to 75 percent of the market in terms of generation. And we have an unregulated industry, which is mortgage brokers, impact and making choices for borrowers with fiduciary responsibility, without looking at the suitability of products. And so I'm not suggesting a suitability standard be imposed on lenders, but rather you have the products out there, but that these brokers be required now that they are such an impact on the market to have uniform federal standards, a suitability test just like the securities brokers do, just like insurance brokers do. That they have some fiduciary responsibility to somebody in the process.

They don't even have a fiduciary responsibility to the lenders, except by contract, which they often breach. But the borrower is assuming that they are going to a professional who is going to give them sound advice, and that's not what we're getting.

This discussion around nontraditional mortgages has to include discussions around suitability standards for mortgage brokers. It is the key to helping the consumers and leveling out all of the markets so that where there is an opportunity for product innovation, we make sure that that product is designed to meet the needs of particular borrowers under particular circumstances.

None of these products, in and of themselves, are onerous evil products. But if you put these products designed for two percent of the best customers of the prime market in the subprime market and layer them, there is absolutely no suitability for those products to be there. And we really have to look at that. And we really have to look at wrestling with this problem of the change in how the mortgage industry has come about. And really have to wrestle with the role that mortgage brokers are playing in this entire process.

MEMBER EGGERT: Sheila and then Bruce.

MEMBER CANAVAN: With regard to the suitability issue, I represent a lot of elderly people. And often times, you know, they know that a fixed-rate loan is what's suitable for them. But they get sold into another kind of a loan. And I think that the agency guidelines don't address, and I would like them to, disclosing to consumers what products are available to them.

I've seen sales pitches where people are told we have 30 different loan products, and that gets someone in the door. And then when the person gets there, it's a total lie. They have one or two available to them.

And particularly for an elderly person or someone who has transportation problems or whatever, making that decision to go in and meet with someone is a big decision and they're not likely to go two or three other places maybe because of what's available to them in terms of transportation or something else.

So I think anything that we can do to encourage people to disclose and honestly disclose what products are available to them is just as important as disclosing the terms of the product that they get.

MEMBER EGGERT: Bruce and then Anne.

MEMBER MORGAN: Thank you.

I commend the Board for working with the other bank regulatory agencies on this proposed guidance. As a community bank, I don't really have a dog in the fight on nontraditional mortgage products. But I would echo what the other bankers have said to you today.

Be sure and keep it as guidelines, keep it flexible and let the financial markets and innovation continue to develop products that consumers demand.

Making things mandatory in terms of underwriting will directly impact negatively my business as a traditional mortgage lender. And I am a traditional mortgage lender. Two-thirds of my loan portfolio are real estate loans. And we closed loans in 16 states last year and it was conventional product, fixed 15, fixed 30 A borrowers. There need to be products for those folks that don't fit that pattern. And it needs to be flexible.

I would also commend the Board on some of the financial literacy materials that you're prepared in the past for the traditional market. One of the booklets that we hand to every consumer that walks in the door is "When Your Home Is On the Line." It's an excellent publication. It's been updated by Sandra's staff before. But I would echo what Faith Anderson said, perhaps the Board needs in the interest of financial literacy to develop a book that's similar to that on the nontraditional mortgage market.

DIRECTOR BRAUNSTEIN: We actually have one in development.

MEMBER MORGAN: Great. Great. on

DIRECTOR BRAUNSTEIN: It should be out soon.

MEMBER MORGAN: I would encourage you to get it out quickly. Obviously, it's a complicated discussion that we're here today on.

One other thing I would encourage the Federal Reserve to do in working with FFIEC, a lot of the mortgage bankers are regulated by the states. As a former state Bank Board Commissioner and former Chairman of the State Bank Board, we were very cognitive of the need to get on top of what mortgage brokers were doing outside of the regulatory framework that more traditional lenders are faced with. And I would encourage you to invite the Council State Bank Supervisors to review this guidance and concur with it, and actually through the State Bank Commissioners in the various states get their input and advice at FFIEC.

I'm not sure which Governor actually meets with the other agencies. I think it's Governor Bies, but it would be good if you could bring a participant to the table that actually has legal regulatory authority for mortgage bankers. In the state of Kansas we have extensive authority in that area. But I do commend the Board for the effort.

CHAIRMAN BERNANKE: I think we met with that group yesterday, actually.

MEMBER MORGAN: Oh, thank you, sir.

MEMBER EGGERT: All right. Anne and then Carolyn.

MEMBER DIEDRICK: Thanks, Kurt. This is also following up on conversations that we've just had with Bruce and Stella. And it's the guidance as it regards third party originators.

Lenders currently have a responsibility to appropriate monitor the activities of third-party originators. Generally accepted standards and controls for approving and monitoring third-party originators include licensing reviews, experience requirements, net worth requirements, public record searches, watch and exclude lists, fraud product screening, quality control reviews, due diligence file reviews, contract representation, warranty, and remedy provisions. The proposed guidance seems to call for obligations in excess of the generally accepted industry standards. It is not reasonable to require financial institutions to ensure that third-party originators are in full compliance with all laws and regulations pertinent to the lender. It is virtually impossible to effective monitor up front marketing and borrower disclosure practices by third-party originators on a real time loan level basis.

Marketing and disclosure practices should be dictated by modification to existing federal laws and regulations applicable to all originators and lenders. And I just want to go on the

record for that part.

Thanks, Kurt.

MEMBER EGGERT: Thank you.

Carolyn?

MEMBER CARTER: I just wanted to follow up on something that Alan said about going beyond disclosures and the Board's authority to deal with other practices in the mortgage market that disclosures won't solve.

And as I read section 129(l) of the Act it gives Board quite broad authority over mortgage lending practices and does not seem to be at all limited to federally regulated entities. It says it's discretionary regulatory authority of the Board. "The Board by regulation or order shall prohibit acts or practices in connection with mortgage loans." That doesn't say federally related mortgage loans. "That the Board finds to be unfair, deceptive, or designed to evade the provisions of this section;" that is HOEPA.

So I'd suggest that the Board give serious consideration to imposing some actual substantive requirements, not just for nontraditional mortgage lending but for the broker problem is not confined to exotic loans, just for example, but that the Board ask its legal staff to look at its authority under that section and use it as a basis to impose some of these substantive protections throughout the mortgage market.

MEMBER EGGERT: Lance?

MEMBER MORGAN: Just a quick comment on the broker issue. I also work in a community where you know everybody and so you have to be careful how you treat them. And so that's an overriding factor. But when you're in a situation where you don't know everybody, then you have a regulatory hole, then what you really have left guiding you is guilt. And I spent a year in government and I made up a phrase about guilt called "Guilt only works on the good." And so I think there is a problem there, it's just how to address I don't know. But I think it is clear there is one.

Thank you.

MEMBER EGGERT: Alan?

MEMBER WHITE: Just one more thing about brokers and suitability. I do think that if there is a reluctance to either legislate or regulate at the federal level, that getting the state regulators together as Bruce suggests is an excellent idea.

I know the Pennsylvania Banking Department is currently looking at draft

suitability standards for licensed brokers to address specifically these problems. And I think both from the industry and consumer standpoint it would be useful to see if those efforts could be coordinated and there'd be some uniformity or standardization or at least some models put out as to what state regulators ought to do about the broker duty to provide suitable mortgage products.

MEMBER EGGERT: In the last -- oh, I'm sorry, Governor Olson?

GOVERNOR OLSON: If I can just make one broad observation, and having been around this issue for a number of years, when the consumer issues first came up decades ago the issue was approval/denial. And we moved from an environment of approval/denial to an environment where we were looking at pricing in addition to. The approval/denial did not go away, but the mischief was all done in the pricing.

We went from there to an environment of what we've described here, some of you, as being concerned about the asymmetric knowledge, you know which was a significant issue. And we have gone there I think now to a question of whether or not there is symmetry in the risk exposure. And that means in part that there's a question as to whether or not the lender that had a risk exposure for bad underwriting still does because of the flexibility of the secondary market and whether or not risk is being appropriately priced in the secondary market and the impact that that may have on the borrower. And that's a real issue.

Mortgage lenders are nervous about the term "suitability," which is a term that applies to investment products being applied to mortgages. And they've said what does suitability mean? And what it means, frankly, is it simply means underwriting.

So where the circumstances that Anne and Bruce mentioned where that underwriting still exists because the fact that you're talking about portfolio lenders or you're talking about conforming product, there is a real question with some of the nontraditional products that are being sold into a market that is quite new.

The point that I would want to make is that that progression will continue and the pace will accelerate. There is nothing that would suggest that will not be the case. And so the environment that we're looking at is to find a regulatory structure, and frankly a legal structure, that recognizes that fact.

Another component of that is that every part of this progression has brought more product into the market available to more people, which has had a lot of societal good but some societal risk. And that's what we're trying to balance.

And this discussion has been extremely helpful in terms of allowing us to think through what some of those issues are.

MEMBER EGGERT: Thank you, Governor.

Is there anyone who wants to -- we're at 11:00, which is when we're taking our break. Does anyone else want to have the last word or should we end now.

Well, thank you all.

CHAIRPERSON SWANSON: Okay. Great. Right on time. That's great.

MEMBER EGGERT: Under budget.

CHAIRPERSON SWANSON: Under budget about 30 seconds.

We'll take a 15-minute break. Come back at 11:15 and then shift gears and talk about electronic fund transfers and debit cards.

Thanks.

(Whereupon, at 10:59 a.m. off the record until 11:24 a.m.)

CHAIRPERSON SWANSON: Okay. Our next portion of the Committee meeting is a discussion of the Electronic Fund Transfer Act and Reg. E.

In 2004 the Board proposed changes to Regulation E that would apply the Regulation E provisions to payroll card accounts, including the requirement to provide periodic statements. And an interim rule was issued on that topic in December of 2005 which applies to Regulation E to payroll card accounts but exempts periodic statements if other requirements are met.

Yesterday members of the Depository and Delivery Services Committee discussed the interim rule and comments which have been received by the Board on it, and as well discussed other issues relating to debit card transactions. And with that I'd like to introduce Forrest Stanley, the Depository and Delivery Systems Committee Chair who will lead the discussion on this topic.

Forrest?

MEMBER STANLEY: Thank you.

You took my speech away.

CHAIRPERSON SWANSON: Sorry.

MEMBER STANLEY: It's an interim final rule, which I'm still trying to figure out what an interim final rule is. But the interim final rule does provide Regulation E consumer protections to payroll cards. There is a provision in the interim final rule that makes periodic

statements optional if the issuing bank makes that information available via telephone, via electronic means and also provides a written copy of it if the consumer requests it.

The two main discussion topics yesterday that we're going to lead, as you heard today, are:

Number one: To some degree the scope of the rule. The rule as currently issued provides coverage if the card is indirectly or directly established by the employer. There are other stored-value products that payroll could be added to that are not covered by the Regulation E rule.

And the other issue that the Board asked us to address was whether the interim final rule strikes the proper balance between continuing to allow innovation and putting unnecessary burden on the product, at the same time providing adequate protection.

There's a second topic, which we have 40 minutes or so and I'd like to according to how much time, save at least 15 minutes for the other topic.

Carolyn?

MEMBER CARTER: Yes. Thank you. I'd like to commend the Board for having amended Regulation E and applied the Electronic Funds Transfer Act to payroll cards. It's important protection for consumers.

To address the scope questions I, and I think I speak for other consumer groups, would have liked the Board to have applied the Electronic Funds Transfer Act to a broader universe of payroll type cards and cards similar to payroll cards. And two things in particular.

First, the rule as written only applies when the employer obtains the payroll card for the worker, but there are kinds of payroll cards that the worker can obtain on his or her own and then arrange for the employer to deposit the wages into that card. Some of those, as I understand it, allow the worker to also transfer his or her own funds to the card. But I don't see why that makes a difference as to coverage under the Electronic Funds Transfer Act.

So I'd first urge the Board to give serious consideration to eliminating the proviso that it must be an employer provided card and allow coverage of employee arranged cards.

Second is other recurring payments such as unemployment compensation, child support, worker's compensation. It's my understanding that payroll type cards are being aggressively marketed, especially to states as a means of providing child support payments to people. Based on the explanation accompanying the amendment to the rule, the Board indicated that although some card products may be used to transfer significant or important sums to a consumer, these products

are generally designed to make one time or a limited number of payments to consumers and are not intended to be used on a long-term basis.

Now there are some kinds of transfers, for example, of bonus payment to an employee that would be one time transfers. And I understand the distinctions the Board is drawing there, although I don't necessarily agree with them. But for unemployment compensation, child support, and worker's compensation those are likely to run on just as long as an employment relationship. Child support is an obligation that will run for 18 years. And since some of the decisions the Board made about Regulation E and the payroll card contents on based on the premise that employees who get their pay through payroll cards are likely to be transient, I would suggest that even the unemployment compensation typical six-months' draw period is not all that different from the length of time that a typical employee would be getting wages through a payroll card. So I urge the Board to treat those as long-term payment methods, too. And either to amend this rule so that it applies to those or begin right away a procedure to expand this rule to those other types of payroll cards.

MEMBER STANLEY: Josh?

MEMBER PEIREZ: Thanks, Forrest.

And I can't remember being so happy to have a consumer issue facing my industry just so that I had something valuable to add to the discussion.

And I also would like to commend the Board for their application of Regulation E in the way they have to payroll cards. And I'd also like to commend the Board for actually taking an approach that's quite reasonable in applying this to a very limited type of payroll card that has gained a certain amount of traction already in the marketplace while using the time to analyze how the application of Regulation E to this type of payroll card might impact other types of cards. That's not to say that might not ultimately be an application of Regulation E to other forms of prepaid cards or the type of cards that Carolyn has described. And I can talk a little bit about some of them at some point.

Additionally, however, I would note that these cards are replacing what are currently generally speaking check or in many cases cash payments made by individuals, entities, or governments to consumers. There are no protections with the forms of payment those consumers are currently receiving. The cards that they receive, however, when they're MasterCard branded certainly, and I think this is true for some of my competitors, receive automatically (R) zero liability

protection, which is a voluntary protection that we've put on these cards. Consumers are not responsible for fraudulent use. They're protected against loss of the card, which they would not be protected against in a cash payment or check payment situation. They also receive the ability to access those funds, in many cases at ATMs, but certainly to utilize those cards for purchasing things on the internet for example that they might not be able to do with a check or cash payment, for making purchases on the phone or by mail order for using those cards for other forms of transactions where cards are beneficial to them.

It also gives them the ability to get comfortable with card payments.

And in the payroll card context there were two important distinctions that lead us to be supportive of the position the Board has taken. One, they were gaining significant enough traction that there are some people out there in significant amounts with these cards and using these cards, and protecting those consumer is really very important. And secondly, it is their primary source of funds in most instances, particularly when it is an employer provider card, which is why we also are supportive of that distinction, at least at this time.

When the employer provides the card to the employee, similar to the discussion earlier about brokers. And this is not to equate employees to brokers, but the card is really being presented to the employee by the employee at the initiation of the employment relationship or as an alternative to receiving payment from the employer. The employee, you know, will take the card in many cases in that context and in trusting their employer. That is quite different from a situation where an employee goes out in the markets, gets a card themselves, makes a voluntary decision to have their pay put on that card rather than given to them in cash or check form, provides other ways in which they're going to load those cards with funds.

We've certainly said in that context we think the unauthorized purchasing type fraud that could result on those cards should be protected. We think it should be protected by law. However, we've provided that protection for our branded cards anyway at a zero liability level, as I mentioned. So we think that's an important protection. However, we're not sure that the full breadth of Regulation E application really makes sense in that context. Certainly not at this point in the product's life cycle. It is too early and it will scare off innovation and development of these products at this point in time to apply the full breadth of the set of regulations that were really written for an entirely different type of product.

Now don't misunderstand me to say that consumers should not be protected on

these products. They should. But taking a regulation set that's developed in one context and applying it wholesale to brand new products that were not even envisioned at the time that the regulation was written is not always the best way to go. In the payroll context we think the distinction for periodic statement requirements was an excellent one, and excluding that requirement in connection with the payroll cards. Because whether it's because they're migrant workers or don't have physical addresses or, frankly, are just scared of the banking system, these consumers don't necessarily want those statements every month. And certainly the cost that is created in providing those statements every month may not be warranted or may leave the products to be more pricy; then we'd be having a discussion that these products are too pricy.

So I think that certainly providing consumers the ability to get that information, to get it in writing if they want it, to get it by phone if they want it makes sense. But we would just urge the Board to take a wait and see approach on these other products. We may very well be supportive of application of some or of Regulation E to some of these products over time. But at this point none of the other products have reached a critical enough mass that we can tell for sure whether these consumer issues are significant with these products, whether consumers really don't understand how these products work and they're much more voluntary for consumers than the payroll cards tend to be because of the employer provision of those cards.

MEMBER STANLEY: Faith.

MEMBER ANDERSON: I would just like to point out an issue that's out there for financial institutions that the employee who receives the card may not necessarily be a customer of the financial institution. And so right now because of the big emphasis on Bank Secrecy Act and what our regulators are doing, that will be a hinderance not knowing if we should do OFAS searches, file NCRs or CTRs, or do anything. And someone had mentioned Privacy or there might be status escheatment laws that may apply. And I just wanted to point out that that might be an issue.

And someone yesterday had mentioned well you might not necessarily want the Board to research all of that, and sometimes no good deed goes unpunished. But I just want you to know that that is an issue.

MEMBER STANLEY: Mark?

MEMBER METZ: Following on John's comments, thank the Board for the work that they've done so far on this rule. And also appreciate the fact from a financial institution that we don't have to provide written statements. However, where someone requests it we will provide

statements within 60 days or require 60 days. What I would urge the Board is to continue to, I guess, do that flexibly in terms of what constitutes a written statement. Right now we can provide statements, we can do that without much expense. But these are very thin margin products I think for banks. And allowing us flexibility to provide statements through things ATM, which you can provide, is beneficial to us and I think keeps the margins down and also serves the goal of what the Board was trying to do.

MEMBER STANLEY: Ed?

MEMBER SIVAK: I want to think about the payroll cards, the product, for the bank. Like tenant/landlords, you're going to use a payroll card, it's probably because you don't have a bank account. In light of that, we need to talk about the question we've been talking about over the past couple of days is how do we move people who are unbanked into the financial mainstream. Dr. Xiang from the Federal Reserve Board encourages us to think about taking the long view when we're looking at product innovation. If we take the long view on this product, it could be a stairstep in product to moving people from the payroll card to a debit card, an ATM card, getting them into the financial mainstream. However, if we're going to do this, I think we need to do this in a way that prepares folks for the responsibility of having a checking account, having a savings account. And part of this is getting a written statement. If folks want to opt out of the written statement, I think that's their choice.

I want to talk about the efficacy of getting your statement online if you're a low-income person in a rural area. Internet access is a challenge, much less high-speed internet access.

I also want to challenge the efficacy of using a phone to record 30 transactions in a month.

So one suggestion that I might make is let's opt out of this. Let's look at this as a way to move people into the financial mainstream and not just simply look at it as a means to an end.

MEMBER STANLEY: Carolyn?

MEMBER CARTER: I wanted to say something about the accounts statements. And I think an opt out procedure of the accounts statements would certainly be an improvement. To my mind there are two purposes for accounts statements, one is the balance check. We had a presentation about there was some discussion of a -- you did focus group testing. And the focus group members some of them liked written statements and some just used other means --

MEMBER STANLEY: Most used other means.

MEMBER CARTER: Yes. And to my mind the internet and the phone are good ways to get real time balance information so that a low-income wage owner knows I have $350 left on this card, I can buy groceries, I can pay my bills or I can't. I have to defer some things.

The written statement, thought, is really really important for things like fraud detection and examining unexplained charges. And it could be, I don't know, but it could be that in your focus group you mostly had people who were concerned about their balance from time-to-time and hadn't had an experience of an unexplained charge or a fraudulent transaction, because I think that's probably a smaller subset, but it's a very important issue.

So the option of getting a paper statement is very important for that. Both fraudulent charges and then unexplained charges like bounce loan charges, you know these payroll cards can morph into ways of getting pay advances. And we just don't want to see high-fee products developing as a way of draining the income, the payroll, the wages away from low-income workers who are using these payroll cards.

As far as ATMs go, I have some concerns about ATMs as an option. And first for many ATMs there's a fee. And the rule requires that at least the phone access be readily accessible, the balance check through the phone. And if there's a fee for any of these types access, I don't consider that readily available, especially when we're talking about a low-income worker's wages are stored.

Second, ATMs tend to be public. They're in public places. And getting your account history when there's three other people waiting in line behind you is just not the best way to do that. So I look on ATMs as an undesirable -- a less desirable way of getting the information.

MEMBER STANLEY: Joshua?

MEMBER PEIREZ: Thanks, Forrest.

I think I want to elaborate for a second on Mark's point about the profit margins on these products. Because I really think it is extremely important, much more so perhaps than in other context because of how slim the margins are on these products that every incremental cost is quite significant to their viability long term.

Before I do that, however, I also want to note on Carolyn's point related to fraud or unexplained charges, because that is a quite significant concern for us as an organization always on all products, which is why we have zero liability protection in place and why we feel so strongly that no consumer should ever be held responsible for charges they did not make, even when federal

law allows $50 or $500 or some other unlimited amount. And to that end our research an information shows that payroll cards tend to be used at less merchants and for fewer transactions than other types of card products generally are. The people who take these cards generally shop in a few distinct places pretty consistently, they tend to have less income overall based on the nature of who these products appeals to, as Ed was pointing out, being unbanked in large part. They tend to have a pretty good handle on exactly how much they actually have.

And so even if they just got information on how much was left on the card, that usually triggers to them, and what we've seen so far, that there may have been a charge they didn't think they made and causes them to follow up on that through one of various measures.

In terms of ATM or internet or phone our general view is giving the consumer as many options as possible is the best course of action. And, Carolyn, you may well be right that that many consumers would not like to have to get that statement in a public place. And I have no doubt that that's true. And those consumers should not go and get that statement in a public place; that's why there are other avenues for them to get it. But I think we should give the consumers credit. They realize that if three people are waiting behind them, they may choose for another option. And I would hate to see us limit the ability to provide it at an ATM if some consumers do want that opportunity or by phone if some consumers want that opportunity. It should be left to the consumers in the market on that end.

In terms of the profit margins, I just want to draw a comparison between these payroll cards, and it's generally applicable to other prepaid cards versus debit cards or credit cards. And we'll start with credit cards.

On a credit card there are many streams of possible revenue for a financial institution. It could be interest if it's a revolving balance. It certainly can be the transactional revenue that flows through our system in the form of interchange fees. It also can be annual fees or various other types of fees depending on the product, the benefits it brings and the particular relationship the consumer has. It also is going to be a fairly long-term relationship. They tend to be fairly sticky products for the majority of consumers.

In a debit relationship the card is really an attendant feature to a checking or depository account. The ability to make revenue off of that overall account is also, again, has many opportunities for a financial institution. They can do it through many means related to the checking account or the card, or both. The transactional revenue will exist as well.

The payroll card is quite different. The only opportunities for revenue are whatever fees are charged to the consumer and whatever amounts of money flow through the system in the form of interchange or other transactional fees. In that context it's relatively small because the transaction amounts tend to be relatively small. The amount of money on these cards is pretty low. So the amount that people can spend is pretty small. To the contrary, providing the card product to the consumer, providing the disclosures, having the systems that can access the necessary information, providing the customer support requirements, reissuing cards if it's lost or stolen, providing fraud protection even on one or two fraudulent transactions are already baked in costs to the product that significant.

When you go into a situation of mandating periodic statements or putting in place a system where consumers get periodic statements unless they affirmatively find a way to opt out of it, even though they may not want it in the first place, or other mechanisms that add any costs to the financial institutions, the low margins that already exist on these products get even slimmer. You end up with much fewer players in the market, less innovation and these are products that are still very, very young in their life cycle. So I would just caution the Board, again, to take the approach you've already taken, which is very much to wait and see. I think we have a good test case on these employer provided payroll cards to see how the market evolves with the application of most of the provisions of Regulation E. And I think that we would be best served to see how that plays out over the next 12 to 18 months.

MEMBER STANLEY: Stella and then Kurt and then Dorothy, and then we'll go onto the next topic.

Stella?

MEMBER ADAMS: I just want to point out, my daughter has a payroll card. Her employer pays her through the payroll card. And while the margins may be tight on you as lenders, they're tighter on a college student trying to make it in the world. And so it's important, some of the difficulties that she's run into is that they're not treated as a debit card, and so there are certain places that she can't go and buy groceries or do things using the payroll card. She has to find an ATM for the lender that issued the payroll card, get money out of the machine, then run to the bank -- then run to the store to make her purchases. Fortunately, she has transportation but if you don't have transportation and that ATM is not available, then you're charged foreign ATM fees.

She had a bank account that if she had had the option, she would have gone direct

deposit to her own account. But that was not an option that was made available to her by her employer. So not everybody who is on these payroll cards is on there because they're unbanked.

There is not the kind of ready access and use of them. And she certainly has to go to the ATM of the lender involved in the payroll transaction to find out what her balance is so that she knows how much she can go and shop. So a periodic statement, even if it were available at the ATM terminal where she can monitor her transactions, because she is really good with her finances, you know learned from our mistakes, would be beneficial to her. But again, she has access to the internet, to a phone, to a car and to an ATM. And I don't know how typical she is of folks who are involved in that transaction. They either don't have the transportation, don't have the access to the internet. And so getting to and from the appropriate ATM machine where they can keep their margins to build some wealth with, this is important. So it may be important to have at least a periodic basis something in writing.

MEMBER STANLEY: Kurt?

MEMBER EGGERT: Forrest asked earlier what an interim final rule is. And I just wanted to note that it's the opposite of a final interim rule. I thought I'd clear that up.

When we're talking about periodic statements and how useful they are, I think it's good to keep track of what our options are. One option is to require periodic statements on all such cards. One is to give an opt out to people who don't want them. And another one is to give an opt in to people who do want them.

And studies have shown that most people tend to stay with the default of whatever is given them. And if you have an opt in program, it may be that only the people who want the periodic statements can get them.

I haven't thought greatly about this issue, but I think that that's one idea that should be kept on the table.

MEMBER STANLEY: Dorothy?

MEMBER BRIDGES: For a bank that --

DIRECTOR BRAUNSTEIN: Excuse me. I'm sorry, Kurt. Can I just -- but that is what's in the proposed rule right now that if somebody wants them, they can request them.

MEMBER EGGERT: Right. But they have to request it for each statement or they can request that they get them regularly?

DIRECTOR BRAUNSTEIN: They request it for each statement.

MEMBER EGGERT: Yes, but that's different. That's sort of requesting each statement means that every month if they want to get one, they have to request one. But it would be different if they could say I want to get monthly statements for as long as I have this card. And they only have to do it once and not regularly.

DIRECTOR BRAUNSTEIN: I'm sorry, Dorothy.

MEMBER BRIDGES: That's fine.

Speaking for a bank that was really very interested in looking at the payroll card as a resolution to ways to very effectively and efficiency serve a significant unbanked population, we happen to have a number of not-for-profit organizations who have clients that they write checks to. And sometimes those clients have not the proper identification and can't speak English. And so they're unable to effectively communicate. And they come into our lobby. And usually on Fridays or the first and the 15th of the month. It takes a very long time. Now I'm not complaining, that's what we're in the business to do. But we thought about offering these cards to make it not only convenient, meaning that rather than 9:00 to 5:00 in our bank lobby, they've got a 24-hour access. And rather than walk out of our bank, which is in an urban core and sometimes crime happens around our bank; rather than walk out of our bank with cash, they've got a card that they could feel relatively secure. And so the profit margin, there are some other things that you're saving to justify those things.

My concern about a couple of things that have been stated earlier, the first of which is denying access to people who have these cards to use ATM if that's their choice. I don't think we can legitimately do that because I think it would be a form of discriminatory practices. Because traditional cardholders have access to ATM history. And so we should allow for these individuals to have the same access.

And secondly, the opt out provision really, really puts the onus on the user to take a specific action. And sometimes when we do that it makes it inconvenient for them. And so I would urge us to really, really think about if we make these kinds of provisions what they actually do to the end user.

There are a number of people using these cards that are a transient. And what happens in that environment is mail comes back to the bank and we have to go through several iterations of trying to find somebody, which adds to the cost. And eventually if the volume -- and like it or not at the end of the day we look at how much it costs us to deliver a particular product.

And if it costs too much, we don't offer it anymore. And I'd hate to see us as an industry move down that path, particularly for an important product that as an alternative delivery method and moving people from unbanked to banked, although I'm learning quickly that maybe that's not the major population. Maybe it is the population of people who already have checking accounts. But the convenience of these kind of delivery methods, making sure that whatever we put in place really is something perspective of the end user.

And then the final thing that I think I want to iterate, and I think yet again we have unanimity because when we discussed this at our Committee meeting it's no question, everyone around the table is trying to figure out a way to get the same end. And that is to protect our consumers. And what I heard consistently, unanimously is that we think given the customer, the history on this kind of product, delivery makes sense. It's just trying to figure out how you do it, balancing what the banks have to do and what they ought to be doing with what the consumers actually need. And in fact, I asked the question in the Committee as to whether or not there has been a resounding number of consumers who are already using this card, whether they see the fact that periodic statements is a problem or not a problem.

And so in effect my final point is let's make sure that when we put these kinds of limitations and restrictions and must dos in place that we're really serving somebody other than accountants and printers.

MEMBER STANLEY: Thank you.

First of all, I think everyone does agree that it is a great product. That it is an evolving product as the whole stored-card value industry is, and it will be interesting to see how it develops, how it's used and how it grows. And I'm sure we'll probably be discussing this again in future meetings.

There was one other topic that I don't know we actually planned to discuss, but it became popular yesterday and I want to save a little bit of time for a general discussion today. It's reported, part of it in the media recently and it's not well understood by consumers, the effect of what we'll call a debit card hold.

If you're using your debit card for example to purchase gas, let me just give you a simple example of the unintended effect of a debit card hold. A person goes to a gas station and swipes their debit card at the pump. They don't go instead. It's not a POS transaction. You swipe your debit card at the pump. In many cases this has to be authorized by the bank. The reason, in the

past there was a $1 authorization. But as gas prices have crept up, now you'll see these preauthorizations of up to $75. That then gets posted to the customer's account. The customer may in fact only pump $30 worth of gasoline. And until that transaction clears, that preauthorization of $75 will have been posted to the customer's account and may result in overdraft charges.

Notwithstanding relatively simple example, it's actually a very complicated problem. There are at least three entities, many times four or five entities that are involved in the transaction; the merchant, the merchant's processor, the issuing bank, the issuing bank's processor, which may not be the same as the merchant bank's processor. And it is a relatively recent phenomena that we've seen in the marketplace.

And with that, I'd like to go to Josh first because he knows more about this issue I think than anybody around the table here, and then we can also have comments.

MEMBER PEIREZ: Thanks, Forrest.

I think this is one of those topics I'm going to go out on a limb and guess that we'll be discussing at some future meetings as well. So I think in the six minutes we have to discuss it, we're probably just going to lay some groundwork.

And so to that end rather than going through all the specifics, I think it's important to note that holds have been on every transaction, on a credit card or a debit card or a prepaid card. It's very standard. It's exactly what happens when you make a purchase at a merchant, that merchant does not get money that moment. You know, they get it sometime later. Maybe that day, maybe the next day, maybe as far off as a week or a couple of weeks from that point in time. And they let you walk away with the goods or services while you're there, typically in under two seconds. That's an amazing proposition to a consumer and a merchant and it happens because of guarantees throughout the system.

What's happened in this particular area of holds, however, is an accommodation to new types of transactions and particular concerns for both merchants and consumers and financial institutions in that channel.

So in the gas station environment if you go back a number of years, you can remember an environment where you could not swipe your own card at the terminal and pump your own gas. It was all full-service gas stations. And then you had some self-service gas stations where you pumped your own gas and they trusted you enough to come in and pay afterwards. Gas stations experienced tremendous theft in that environment. They also experienced tremendous robbery when

the person had to sit there holding wads of cash and doing full service in isolated gas stations around the country. So they moved to these cardholder activated terminals, now typically called CATs machines.

These terminals allow you as a consumer to pump your gas, typically at a somewhat cheaper price than if you got full service since there's no employee costs and to do it without having to leave your car.

Now for those of us with young kids who often fall fast asleep in the back of our car while we're getting gas and the thought of waking them and having them scream so we can go inside and pay is quite unattractive, this is an extremely appealing proposition to just stop and get the gas while they're asleep. However, with that channel once again if the gas merchant allowed you to pump as much gas as you wanted and then come in and pay, they would face major risks of theft. And, in fact, that proved itself in reality. So what they did was they started to make you put in a card and authorize the transaction in advance of allowing you to pump gas or come inside and give $20 and they'd activate the terminal for $20 worth of gas.

Now they started, as Forrest said, with a $1 authorization which told them that it was a valid card that was live, but with prepaid cards and gift cards and debit cards with people with low balances, the person may have only had $10 on the card and they pumped $45 worth of gas, pump it for their friend behind them and the merchant is left holding the bag because they only got an authorization for $1. So our system only guarantees them that $1 payment. So they moved to a $50 authorization, which was pretty much standard in the industry prior to Hurricane Katrina.

When gas prices jumped and $50 was no longer sufficient to fill a tank, they moved up to the $75 authorization to confirm that someone could pump up to $75 worth of gas and they would be authorized for up to that amount.

The problem is that the message that comes next after that authorization message, which is known as a clearing message, that message comes typically later that day or a day or two later. It often comes from a different processor. The merchant may have one processor for authorizations and a different processor for clearing. And since the amount does not match up to the actual amount of gas that purchases, technologically when the issuer receives those messages, they don't necessarily electronically match up such that the initial hold is canceled out by the finished transaction.

In the typical transaction you go in, you by a $100 TV set, later that day a

message comes through says yes, I made that $100 sale, that gets wiped off right away. In this particular environment of gas stations and a couple of other channels, that's less than clear to an issuer, particularly technologically. It's not like someone is there saying oh this probably was that transaction. They look for the exact match, and that often doesn't exist. So it is a real problem. However, I think it's less significant in terms of its overall impact and occurrence than some of the press accounts may have led some people to believe. And I think it's something that certainly warrants some future discussion by both the Committee and the full Council with perhaps some more time dedicated t it.

MEMBER STANLEY: I just want to note that this is the first time, at least in my memory, that allowing children to sleep in a benefit of financial services.

This probably will be a topic that we will carry over to our next, at least, Committee meeting. Probably at the public meeting. And with time short, I want to turn over to Kurt or Lori, do you want to--

CHAIRPERSON SWANSON: Sure. Our final topic for the day is, switching gears once again, and that's Truth in Lending. And yesterday members of the Consumer Credit Committee discussed the new Truth in Lending Act provision to the federal Bankruptcy Act and as well heard an overview of comments received on the ANPR issued by the Federal Reserve in October. And so, Kurt, if you can lead the discussion on that topic, that would be great.

MEMBER EGGERT: Okay. There are essentially two areas that we were asked to address. One involves the prompt crediting of payments and the other involves the Bankruptcy Act amendments to Truth in Lending and what disclosures are required and how do those work.

So I'd first like to turn to the first line of questions, which is the prompt crediting of payments. The Board has asked for advice regarding essentially how prompt is prompt. If someone makes a payment at 5:00 in the afternoon, when is that payment credited? Are they credited as having made the payment that day or is it held off essentially until the next day?

We heard in our briefing that industry cut offs as far as when payments are credited vary from 10:00 in the morning until late in the day, perhaps even midnight. And so what we've been asked essentially is should the Board require payments to be credited however late in the day they're made or should there be a uniform time, should there be a variance between checks and electronic payments or should the Board step in on this issue?

And so I'd like to turn this over to this Committee to discuss and turn to Forrest,

who has agreed to step to the plate.

MEMBER STANLEY: I just had one problem yesterday that I'll repeat today about the issue. And that is, I mean currently there is a Fair Credit Billing Act that is part of the Truth in Lending Act that required creditors to post payments on open-end credit on the day they are received. There is a provision in there that we can establish a posting time that if we received a payment by such-and-such a time we will post it that day. But if it's after that time, and that disclosed to the customer, it will not be posted until the next day.

While it may seem to be a tremendous -- well, while it may be a benefit to the consumer to require the bank to back post that, in other words you're not going to be able to legislate or change the bank's processing cycle. If we had a change that we would have to change it and back date the check, all I was suggesting is that type of seemingly small change is a huge change. And in a world of limited resources where we're all struggling with compliance burden and trying to deal with many issues, I just question whether or not that's a good effort to undertake if the cost of that outweighs the burdens.

Now I haven't actually asked my people to cost it out. But it's the type of seemingly simple change that is not so simple. And may very well may have a very, very large cost. And my question was, which will be another side, is there enough benefit to justify that burden?

MEMBER EGGERT: Mike?

MEMBER METZ: Yes. Following up on Forrest's comments, this might be an area where the banks really don't need any more help, with all due respect. I think this system has evolved. I think there used to be abuses where there was, you know, early, early morning crediting required. And people probably were taken advantage of. I think that has evolved through lawsuits and other actions. And, I mean, I think the system now is, at least at our bank, we post at 4:00. We give consumers the choice. They can pay by phone, they can pay by internet, they can come into one of our branches, or if they choose to, they can mail us the payment and we say then as we're required, this has to be received by 4:00 on that day or it's not going to be credited until the next day.

So I would say that there is already enough in the system and the way this has evolved to protect consumers. And given the choice they have, I think they have a sufficient choice.

MEMBER EGGERT: One of the issues that we discussed yesterday is why is this important? Why do we care so much about the exact posting of payments. And I was hoping that one of our consumer people would address us on that. Carolyn?

MEMBER CARTER: I think Alan's expressed it better than I did.

MEMBER EGGERT: Okay. Alan?

MEMBER WHITE: Okay. Yes. I think that Mark is right, there has been litigation about this very tiny little issue about whether today means 10:00 or 5:00 today. I think that's, in and of itself, not a major problem for consumers. The real problem has arisen from the transformation of pricing in the credit card industry and sort of the diminishing of transparency of pricing as a result of a lot of the revenue from credit cards being generated from late fees, over the limit fees and default interest rates and a number of other provisions that I think are much better dealt with either through looking at pricing disclosure or looking at regulating unfair terms directly.

Another example is the different balance computation methods. I mean, there's a very complex set of different computation methods and you can either choose to try and convey that information to consumers or you can just standardize it in such a way that you don't have to worry about that complexity.

So I think the reason that the issue of posting dates and posting times became so critical is because of the tremendously severe sanctions that a consumer might face with not just a late fee, that's considerably in excess of the actual cost of late payment, but a default interest rate which can be 24, 25, 30 percent and now universal default provisions that result not only in you paying a higher interest rate on this card, but on all your other cards as well.

And so I think lurking behind this small problem is really a broader issue both about pricing in the credit card market and what I would regard as unfair and abusive terms that need to be looked at.

MEMBER EGGERT: Carolyn?

MEMBER CARTER: I would like to speak to the timing issue. And I think that the Board should adopt either a rule that if it's received on Tuesday, it is to be credited on Tuesday or it should go with the postmark date. There are alternative ways of credit card bills, but some of them carry a charge. The phone payment typically carries a charge. And mail is the method used by, I think, most consumers.

As I said, I would favor a rule that said if it's received by Tuesday, it has to be credited to the account on Tuesday. And I'm not saying that if it's received on Tuesday at 6:00, the bank has to make its workers stay and process the payment that day. I'm just saying that the payment should be segregated, just all those unopened envelopes should be kept in a bin and then on

Wednesday morning, they should be processed as having been received on Tuesday, which is the day they were received.

I understand there may be costs involved. It's hard for me to understand how the costs could be very significant. If there are costs, I think the Board should ask that they be quantified and then the Board should itself analyze the extent of those costs.

The payment posting date is important for consumers because of all the consequences for a late payment. It's also highly frustrating for consumers because once they put the payment into the mail, then they lose control over it and often find very negative consequences because even though they did everything right, it is credited to their account as a late payment.

MEMBER EGGERT: Okay. Mike and then Stella.

MEMBER COOK: The only thing I would add to that is without any type of guideline in place, we are almost creating a structure that would create an incentive for that cut off time to continue to moving earlier and earlier in the day. Where maybe it's 10:00 at some banks, maybe it is 4:00 at your bank, Mark. But it is earlier and earlier all the time. And with 40 percent of the revenue coming from late fees and the kickers that take place on credit card interest rate raises, what ends up happening is we're creating a perverse environment that's only going to lead us down this path where ultimately we will end up impacting the consumer significantly. And so I really believe with Carolyn that there needs to be some type of guideline that's stronger out there that says if it's received that day, for example, or even I think Forrest has a good point. We don't want to add costs. I am not a fan of adding cost into this system. If anything, we need help to drive the costs out of this system. But maybe the grace period goes from 30 days to 29 days so you have a clean cut off day and you build into your side that one additional day, for example, so that you still have a solid day that the consumer knows when that cut off time that when it arrives on that specific day.

I recently moved from one house to the other. And in the process, as you can imagine, you lose mail or whatever the case may be. I went to pay one of my credit card payments on-line. Well, on-line with this particular institution took three days for the payment to post on-line. My only other option was for it to be late, which was a $35 late fee, or I could call and it was a $15 fee to make the payment on the phone.

I don't know that you need to know my personal problems, but I think those challenges do exist out there. And that if there were stronger guidelines, it prevents what I would call the honest institutions from being led down the wrong path.

MEMBER EGGERT: Okay. Stella and then Joshua.

MEMBER ADAMS: Mike said everything I wanted to point out.

The other thing is, though, there has to be some enforcement by the regulators when you go in and do examinations where you see folks that are getting 40, 50 percent fees from late fees, to do some examination to see what percentage of that is within 24 hours of the cut off and what percentage of that is on honest and legitimate late charges. And it certainly doesn't seem costly to me to get a stamp that says received today. I don't know how expensive that could be. You do that to the mail as it comes in, and you post it as to when it came into your business.

MEMBER EGGERT: Okay. Joshua and then Gordon.

MEMBER PEIREZ: Thanks, Kurt.

I find myself actually agreeing with 50 percent of Alan's comments, and I'd like to elaborate on that a bit, which is I really think that the only reason anyone is focusing on this timing issue is because of the perceived consequences of missing the cut off, right? Because if there's no consequence to missing the cut off, then no one cares when the cut off is.

So I think on the cut off question I would really highlight, you know, you can mandate 6:00, you can mandate up to midnight, the fact is it's going to be when the mail's delivered, whenever that is. But at the end of the day people are still going to miss the cut off. So I think you're focusing on what really is a small issue, which is when the cut off is, that does have significant cost. And I do hear Stella's point about the staff. And I think 25 years ago in fact it may have been as simple as buying a stamp. Unfortunately today, that's not the way these bills get processed and handled, and that's a much a longer discussion that we can have or not have.

But I think that it really is something that has significant implications. Separately, Mike, I'm always interested in your personal issue and I think you probably need a new card if they're not crediting for three days your payment and we should talk about some MasterCard cards.

MEMBER COOK: In fact is a MasterCard.

MEMBER PEIREZ: Touchè.

MEMBER EGGERT: Dorothy and then Sheila.

MEMBER BRIDGES: Since Truth in Lending covers all lending activity, not just credit card or other, it doesn't distinguish, the concern I have is not so much missing the cut off you know if everybody else is like me, you receive your statement and for the most part you have please pay by. And you've got a long period of time. That's also not to suggest that people can

afford to pay at the time that would make it amenable to the payment getting on time.

I wanted to really distinguish what banks are doing. I can't speak for credit card, but to suggest that banks are deliberately withholding processing payments on the day that it's received, I think it is an inaccurate one.

Financial institutions, for the most part, that's how we generate our income and we want to know everyday what our income is prior to the end of the day. So there is no holding. And I mean, there's a lot of things that are involved in this process. You know, if payments are received in a night deposit box, we generally have a cut off at 9:00 in the morning. And if they put it in a night deposit, we're not going to look at that night deposit before the next day. But the customer ought to know those things.

I mean, there are many different ways that payments are delivered to us, other than the mail, that really trips up this if a customer is waiting until the very last day to make that payment.

What I am more concerned about, and this has happened to my family, not me in particular. But the arbitrary of acceleration of due date of payments that leads to or triggers late charges and increased pricing.

There are some institutions, and I don't know they could be directly to the consumer or indirectly by a retail merchandiser, where credit cards are used for merchandise and then a payment due date is assigned. And then all of a sudden the customers get into the habit of making sure that those payments are delivered prior to that due date. And then lo and behold, the next statement they received a late charge and they said but I paid it like I always do. Well, your due date has changed. And that has accelerated.

So if we are looking at this, this is a little bit more involved than just traditional bank coupon payments and credit cards, but all of those services are delivered through other means. And I'm more concerned about that arbitrary kind of acceleration than I am an individual. And I have to agree with Josh that I think this is a small problem. If you're waiting until the last day, please know that these are some of the things that will happen.

I think credit card companies for the most part if you're MasterCard, Visa and the bank installment you have particular times that are stated opening on your bill when payments should be received and by what time.

MEMBER EGGERT: Sheila?

MEMBER CANAVAN: Yes. I just wanted to briefly say that I think that this issue has tremendous consequences for a consumer because of the presence and prevalence of the default interest rate, which is perhaps more of a consequence even than late fees.

MEMBER EGGERT: Okay. Anyone else want to weigh in on this subject before we move on to the next.

Okay. The second issue that we were asked to discuss was the fact that the Board has announced that it will be implementing the Bankruptcy Act amendments to Truth in Lending as part of its ongoing review of open-ended rules, credit rules. Significant to our discussion is the following change: That creditors that offer open-end credit accounts must provide disclosures on each periodic statement about the effects of making only minimum payments, which leads to two primary questions. What type of credit should this apply to? Should it apply solely to credit cards are also to such things as home-equity loans? And the second question is how do we make the information discussed in the legislation useful information? How do we design regulations that do the most to convey useful information to the customer?

So, let's go to the first question which is should this information be limited to credit cards or should it also include home-equity loans? Mary Jane?

MEMBER SEEBACH: Well, the traditional home-equity line, to the extent there is such an animal anymore, has a draw period and then a stated contractual repayment period. And therefore it's disclosed to the borrower up front and probably also again at the time it recasts over to the fully amortizing payment how much it's going to take off to pay off that line. So I don't think it's necessary in the traditional home-equity sense.

I did hear yesterday that there is another type of product what it might be more appropriate, and I'd defer to Alan to talk a bit about that one.

MEMBER STANLEY: Before we get to that, Faith?

MEMBER ANDERSON: Hi. I'd just like to say that there's credit unions who offer other types of open-end loans where the payment term is set and the amount of payment is known. And for those, because the payment term is set and there's an ending date, it's not helpful to a consumer to receive another notice that this is the minimum payment because they know that that is their set payment. And because there is no -- the type of abuse that's in credit cards where you could be paying it for ten years, we would request that those types of open-end loans be excluded from the minimum payment statement.

MEMBER EGGERT: Are there any forms of home-equity loans that people think there should be these kind of disclosures on? Anyone? Carolyn?

MEMBER CARTER: Well, I'd like to say that there are disclosures that are written into the law that are not appropriate for these types of home-equity loan loans. There's one that says paying just the minimum payment, you'll pay more in interest if you pay just the minimum payment. But to the extent that a home-equity loan allows a person to pay more than the minimum payment, what I'm suggesting is that while at least some of the mandated disclosures are not appropriate for home-equity loans, rather than eliminate them the Board should consider rewriting them so that they are appropriate for home-equity loans. And for example, you could say paying more than the minimum payment. Well, if that's allowed under the terms of the home-equity loan, will reduce the amount of interest you pay.

MEMBER EGGERT: Anyone else on the home-equity loan issue?

The next question is what can we do to make the minimum payment warnings functional? The legislation includes what the warnings should be and how should those be implemented? Carolyn?

MEMBER CARTER: Well, the point of disclosure is to give consumers meaningful information. And this is not the Board's fault, but unfortunately the way the law is written it requires the creation of an enormously complex system that will produce information that is almost sure to be inaccurate. And, in fact, this system will probably put the Federal Reserve Board in the position of operating a toll free number that is going to give out wrong information to consumers about the number of months it will take to pay off their loan, their credit card bill making only minimum payments. Of course, this will be coached as an estimate, you'll be saying it's an estimate. But unless you make the system enormously complex with a huge amount of data entered by the person who accesses the system, the estimate may end up not being even reasonably close to the actual number of months.

It would be much better simply to require creditors to disclose the number of months on the periodic statement that it will take to pay off this balance at the minimum payment.

The Bankruptcy Act doesn't explicitly say that that is an option. The Bankruptcy amendments, I mean. But 1605(a) of the Truth in Lending Act gives the Board a great deal of latitude to adjust disclosures and make exceptions, make adjustments. This is a perfect time for the Board to take that option and require creditors to actually disclose the one piece of information that

-- required that it actually be disclosed rather than an enormously complex system to get that piece of information. I would urge the Board to make it easy for creditors to do it, give them software, give them tables so that the creditor can figure out where on a table the consumer would fit.

If the Board doesn't feel comfortable doing that but feel it has to set up this Byzantine system, I understand that. But I would still urge the Board to give creditors powerful incentives to disclose the actual number of months instead of just disclose the means of accessing this very complex system.

As it is, it's like a game of blindman's bluff where everyone has blindfolds on trying to determine the number of months to pay off the credit card bill within insufficient information. And creditors have the information, they need to make the calculations and it would be much, much better if the Board just required creditors to disclose that.

MEMBER EGGERT: Thank you.

Joshua?

MEMBER PEIREZ: Thanks, Kurt.

First before going into some of the substance, I would just draw a distinction between the Fed's ability to adjust or amend the disclosure and entirely change it. And I think a requirement for disclosure of number of months would be an entire change. The legislation is pretty clear, even though we may not all like the actual outcome of the legislation, although we do support giving some disclosure here. It is important to note that requiring an entirely different disclosure that was most certainly considered by Congress and rejected is not something we believe is either within the Board's authority or, frankly, would be worthwhile even if it were.

That being said, I think it's important to remind us all of what we're talking about here. And I'll cite a paper, an article by Thomas Durkin of Board staff from I think 2000 in which he concluded that only about 7 percent of consumers reported that they hardly ever paid more than the minimum. And so you're looking at a really, really small percentage of the consumers who have cards in the first place that actually make the minimum payment month after month. And so if anything in terms of granting exceptions, we would encourage the Board to not require the minimum payment disclosures to be provided to consumers who are not paying the minimum payment month after month. And we would look at some sort of nexus of, you know, people who have paid the minimum for a certain period of time triggering the disclosure if in fact the Board were inclined to use this exemption authority.

That being said, we also would note that there is no such thing as providing a really accurate number of months here, and there's a number of factors for that. And I know that some of my friends and colleagues here have a really hard time believing this, but it still remains true nonetheless. Because first of all, so few consumers are only going to pay the minimum, if you want to talk about an inaccurate disclosure to a consumer, you are telling them the number of months that will be inaccurate. Not to mention the fact that the moment go out and make another purchase, the disclosure was inaccurate. And, frankly, if it's on a monthly statement, it may become inaccurate by the time that statement arrives because they've made a purchase from when it was mailed to when it's arrived, which is typical for these consumers. So you've given them an inaccurate disclosure to begin with, which is why we thought that the table approach at least had the same benefits as coming up with some raw number has, which is basically to advise consumers that making the minimum payment month after month if you can afford to make more is a bad practice. As a consumer you should pay more every month if you can.

And that is the purpose of this disclosure. Byzantine or not, the Fed System will make that clear to consumers we think if they seek out that information by phone or if they get in a table. And we would encourage the Board to try to keep that approach as clean and simple as possible.

And the last point that I really would like to make because people always say well why is it so hard, can't you just give a number and say it's only accurate as of that exact moment in time, but even something -- we were just talking about the timing of crediting of payments. But the timing of when a consumer makes a payment effects how long it takes to pay off a loan, even if you pay just the minimum. Because if you pay that minimum amount on the second day of a billing cycle versus the last day of a billing cycle, you've paid off that amount earlier in the cycle and you've immediately effected how long it's going to take to ultimately pay it off because the interest on that amount, at least, is not applied as of the day that you've made that payment and had it credited, whatever that trigger was.

So there are a number of other assumptions, and I'm just trying to give one simplistic example to point out to people that in an ideal world it would be very nice to be able to make an accurate disclosure to consumers so that they knew it will take me exactly this number of months to pay this off. There's a number of assumptions you need to draw in order to do that. And, frankly, once you get through the first three assumptions, you've pretty much knocked out almost

everybody you're going to give the disclosure to, so you're giving an inherently inaccurate disclosure which lenders do not like to provide, and should not be forced to provide.

MEMBER EGGERT: Okay. Edward and then Lance.

MEMBER SIVAK: Well, seven percent is a small number until we look at who that seven percent is. You know, it could be people who are having trouble, it could be low-income people. And I just want to make the point that these are the people who we need to make sure we're protecting most.

MEMBER MORGAN: I mean, you know we're over-complicating a problem it seems to me. You could just pick a day and say it's accurate this day and then you're probably okay with that.

And the other thing that occurred to me while I was sitting here just getting so confused about how terrible and hard it would be, it seems to me that when I get credit card bill, it has like about 20 things in it. And they're all intricately related to the credit card and you know, you can buy this or do that or have this program. And I think the credit card companies are able to do that. So I think that it shouldn't be that difficult to do the math on a particular day to make this happen.

And I think I understand your point. But, I mean, it just doesn't seem that difficult of a thing to do.

MEMBER EGGERT: Alan and then Faith.

MEMBER WHITE: Josh and I had a lively discussion about this yesterday, and I do disagree that it's not possible to provide an accurate number to the consumer. It depends on what you mean by accurate. And clearly you have to make assumptions, but all the reg has to do is spell out what those assumptions are: That you're paying on the due date and the rate and the balance remain the same and so forth. The value of this information, the purpose of this provision if you'll recall is bankruptcy provision. And in this country we spent a lot of time looking at our consumer bankruptcy legislation from the standpoint of whether it remedies the problem of excess indebtedness, you know, is a good medicine for consumers who are in trouble. What we have not looked at very much at all is how to prevent people getting in a situation where they're forced to file bankruptcy in the first place.

Interestingly, a number of European countries have spent a lot more time looking at the prevention end in their bankruptcy legislation. And you will see laws that were adopted kind

of looking at the American experience in other countries where in the bankruptcy legislation there are a number of provisions about responsible borrowing by consumers and responsible lending by lenders.

There's a provision before the EU now about responsible lending, which I'm sure the industry hates because it does create a lot of vagueness and subjectivity, I suppose. But the fundamental concept is that if you're the third or fourth card or fifth card issuer to offer a card to somebody, you're supposed to look at their credit report and see if their income and their existing debt can support that additional debt. And I know that's a radical notion in sort of our Anglo-Saxon free market approach, but in that context this provision of just providing a little information to consumers as a bankruptcy prevention method, I'm just very disheartened that it runs up against so much push back from the industry.

And I really would encourage the Fed to try and make a clear, simple, and useful disclosure based on the consumer's actual information. I would agree with Carolyn that some of what Congress put in there is actually going to require misleading information to be provided to consumers. Some of the hypothetical scenarios where credit card balances are paid off in 24 months, you know, if you don't have the actual number that relates to your account, that can be highly misleading and deceptive.

So let's keep in mind the purpose of this legislation and see if we can accomplish it, even given that the problems that Congress created in writing the law.

MEMBER EGGERT: Okay. We were supposed to end at 12:30. So we'll have Faith and then I'll give Michael the last word.

MEMBER ANDERSON: I know that a lot of lenders here would like to give their customers the actual number of months that it would take to make the credit card payment. And so we would support that if, you know, you could give lenders a safe harbor realizing that there are some pitfalls that they can't be as accurate.

And we would also support putting it on a periodic statement where a customer could see it versus having to go to a toll free number, having this hypothetical example that really may not actually apply to that customer. And so if there's any way that you could encourage lenders to give the actual months of payments on a statement, that would be very helpful.

MEMBER EGGERT: Michael?

MEMBER COOK: The only thing else in final is I actually support both sides of

this. I think Faith and Joshua have a great point. I think that's a very valid solution to offer some type of safe harbor whenever there is an estimate provided. I don't know why an estimate can't be provided. I think that that's a very valid solution and that it would be recalculated each month if they did pay on a different payment schedule or ahead of time, or more than what they paid the previous time; there's no reason the next month's estimate number of months to pay off couldn't be recalculated at that as well. And, again, it would be an estimate.

I believe several meetings ago we had an example, Joshua, where we gave where it's similar to the EPA requiring the average miles per gallon. This is an example based on the terrain and your driving habits. Your experience may differ. The same may happen here. It's based upon your payment habits and how much you pay, your experience may differ. But based upon these guidelines, this is what it would take to get to that point.

MEMBER EGGERT: Okay. Thank you.

And thank all of you for your discussion.

CHAIRPERSON SWANSON: Thank you, Kurt.

The members forum is an opportunity for us to hear from one of our colleagues on the Council about their work. And today I'm very pleased that Stella Adams has agreed to discuss her work at the North Carolina Fair Housing Center.

Stella?

MEMBER ADAMS: Thank you.

It's an honor for me to be addressing the Board on some of the work that we do at the North Carolina Fair Housing Center. I know many of my colleagues wonder what in the world does she do besides run her mouth. So I'm going to show you a clear snapshot, because I also want to touch on one of the things that the Board was interested in was this financial literacy and how do we do outreach on a broader basis. And so I want to save four minutes, so stop me when I get ready to run out of time to show you some of the innovative ways that we try to do the outreach into the community.

The mission of the Fair Housing Center is to encourage and support equal opportunities in housing in the state of North Carolina. And as you know, I can make anything a fair housing issue in like three minutes or less.

The Center provides assistance to individuals -- with do continuing education. And we promote community involvement in fair housing issues through research and policy

development.

We have five basic programs that we operate. We do fair housing testing and enforcement. I really am a fair housing agency and operate in the way most fair agencies do.

We participate in the Freddie Mac Don't Borrow Trouble Anti-Predatory Lending activities and we've expanded that to encompass a number of anti-predatory lending activities that are unique to North Carolina.

We have a Recitals for Justice Initiative which is where we take books that are books and other media material into the classroom to teach children about fair housing and financial literacy through those kinds of tools. For example, “The Other Side” is a children's book that we use in K through 5. We use “Raisin in the Sun” to talk about how fair housing discrimination at the high school and adult level.

We do education training, research, and data collection.

This is all here because there was supposed to be music at this point.

In terms of the housing enforcement, we're pretty proud of the work that we do in that area. Last year we had 19 clients obtain monetary awards through private attorneys of $167,000. The U.S. Department of Justice has recovered over $1.3 million as a result of our initial investigations assisting 11 disabled persons get damages and retrofitting units for accessibility. So I do more than go after lenders.

Since 2001 five percent of the Justice Department cases have been based, in part, on our investigations. And we're really proud of that.

Sixty-three North Carolinians last year recovered over $757,000 for an average of $12,000 per client based on all the different kinds of enforcement mechanisms that we had in place.

This is us investigating hate crimes, which we do as part of the Community 2000 Project of the Leadership Council on Civil Rights.

We're also engaged in anti-predatory lending activities. We assisted 137 borrowers with credit counseling, home ownership counseling. When we find, look through their loans and see where activities fall into anti-predatory lending, we investigate those and these are some of the results. We had an elderly woman get her home deeded back free and clear. And we assisted 14 families in getting loan modifications with principal and interest reductions of over $350,000. And this is the lady whose home we got back, and she was really happy.

We also work with Freddie Mac, partner. We do policy work. Those with my

Congressman Mel Watt and Brad Miller of the Miller-Watt-Frank Bill. Not endorsing particular public policy, but I just thought I'd put that out there.

We do data and research, we do quality of life studies. We use cluster methodology as well as price discrimination data.

I want you to know that I have economists back at the office that crunch numbers for me.

We believe that partnering with industry is really important in eliminating discrimination and increasing housing opportunities for people. And so we work with all -- we are very aggressive in working with our industry partners. And I think that most of the people in this room who do business in North Carolina are in fact business partners of the Fair Housing Center.

We do a lot of education and I've trained over 3,000 industry professionals on fair housing and fair lending investigative laws.

We partner with the Community Reinvestment Association of North Carolina to do a lot of unique and interesting things and to create multimedia outreach materials for consumers. One of the projects that we did is we created a short motion picture called "The Other Side" based on the children's book. And we took that -- it's an award winning, by the way. It's a high-quality film that won a short features award at the San Francisco Film Festival. So that's a highly prestigious film festival that it was awarded. And this is a gift to you, my members here.

And that short feature film we expanded to include fair housing education. And every month in April we air it on television across the state. And we see a significant increase in the number of inquiries around fair housing as a result of it that have been -- so this is that information.

And then the piece I've saved. I did good. Saved the whole five minutes.

Nuestro Barrio is our latest and greatest collaboration between the Fair Housing Center and the Community Reinvestment Association of North Carolina. It is a 26-week tele-novella that incorporates financial literacy in the plot lines. However, the plots are full of sex, lies and financial tips. So it has all the drama, all the intrigue of life in a small town that impacts these Latino community members, but it also brings in real life activities related to home ownership, banking, beyond banks and those kinds of things.

And I do have one -- I'm going to show you a clip from that related to predatory lending.

Did I do it wrong?

(Whereupon video plays. Video is in Spanish).

MEMBER ADAMS: It goes on to explain what legitimate fees are and what they aren't. There's a really good explanation about equity comes in and out of your home, the different way that people understand. And that's just a short segment of how it is.

We're really proud of this because it's airing on local stations in our market and it's picked up a two percent market share based on Nielson. And it's the first Hispanic show to actually register on the Nielson. That two percent share is 60,000 households that are reached by this show every week. You can't do that one-on-one. And we meeting people where they are in their homes and in an entertaining way teaching people about financial literacy, about home ownership, about housing -- we do housing counseling, covered the bank, why you shouldn't have mattress money, covering why you need insurance and why that's important. The business burns down as part of one of the subplots and the evil of -- we have a doctor involved and as an outcome the CDC and some other health folks wants to try to incorporate some health issues into the story as well as the financial literacy issues.

Spanish teachers in high school are using this to teach Spanish to their students, but guess what the kids are also getting? Financial literacy training in their Spanish classes. So we're really excited about that new outcome that we weren't aware of, and we're actually going to package it up for Spanish teachers to fit into their curriculums next year.

MEMBER SCHWARTZ: Stella, how can you get that across the country, outside of North Carolina? I'm sure you're working on it.

MEMBER ADAMS: We're working on it. And we are have the product produced but the distribution funds and the distribution channels are the problems we're having in getting it outside. But one of the good things about it is because it did get a market share, we're now getting the interest of -- it's not just a public service activity for the local WB stations. They're actually picking up national sponsors that want to buy time on it. So they're really happy and that, we hope, will help us get it to a broader market. But we will be glad to talk to you about how we can get it in a market maybe.

CHAIRPERSON SWANSON: We probably have a couple of minutes if anyone has any questions for Stella, we could probably take a minute or two.

Okay. All right. The next item on the agenda is to hear very brief committee reports from the committee chairs with regard to both what happened yesterday and what's on deck

for future CAC meetings.

So with that, Mary Jane, if you could give an update on the Community Affairs and Housing Committee, that would be good?

MEMBER SEEBACH: Sure. Yesterday we started off our discussion, an extended discussion on the HMDA data. We had a very good meeting with Glen Cannon who was talking about the credit scoring study the FEDSAP is completing right now on the efficacy of credit scoring and how scores are going to effect access to credit. We're anticipating how that might be useful on our discussion about HMDA and policy objectives with HMDA down the road.

We also, obviously, talked about the home-equity hearings, which we all heard about today.

And we had a very good presentation by the Atlanta Fed on Katrina and the impacts in the region, which is an issue I'll mention that we'd like to come back later in the year.

And we had a very good discussion on affordable housing, which you want me to go ahead and go on into what we're looking at for the rest of the year?

CHAIRPERSON SWANSON: Yes, if you could.

MEMBER SEEBACH: All right. Just keep talking Mary Jane.

Okay. Hang on. Affordable housing. Before Mary Jane leaves this Council we're going to be talking about affordable housing here on Thursday. So one of the big key issues we talked about is the impact of the portfolio caps on the GSEs. It was pointed out to us that the GSEs maintain that 90 percent of the earnings that they're getting on their retained portfolio is used to fund their affordable housing initiatives. And we think that that's an important topic we should probably all be talking about.

Especially as I look around and see the Fannie dismantling all their regional -- I forgot what they call it again. Affordable -- so they're dismantling all those places. I mean I think they're anticipating these caps coming, but it is going to have a big impact on the affordable housing market.

And we also want to talk about incentives the Fed could be considering for creating affordable housing, including additional lending to CDCs, CDFIs.

Also, I think there's a very big issue about subsidizing borrowers once they get into affordable homes. So once we can actually get the housing in a market, how we're going to keep them in there. You know, what are the different subsidies that we can look at.

Also, the link between predatory lending and driving up the overall cost of housing, and especially impacting the affordable housing market.

And then the affordability squeeze on what we would call the moderate income group; teachers, firemen, especially.

So those are a lot of the topics we think we're going to try to take on in the months to come.

We'll probably be coming back to HMDA again talking about policy implications. There's a lot of interest in understanding what the other regulators have been doing with the data that's been given to them on the 200 lenders. And we'd be interested in the Fed sort of doing some sort of follow up of the lenders that were referred out that had issues, was there any action taken or not.

And then Katrina, we're really interested in coming back probably in the fall to talk more about Katrina. Obviously the impact now that the deferrals have ended, what's the impact on foreclosure rates in the market. We all know that the foreclosure rate pre-Katrina was high. A lot of lenders have held off on moving forward with those. Those are going to start up pretty soon. But generally with the rest of the market, what's actually going to happen there.

Also we have a lot of concern about the CBG Fund and how those funds are going to be distributed. There looked like there was going to be, once the cosign had happened on these funds coming out of the states, that it was going to be complete discretion on the borrower to expend those funds with no checks on it, which we think has great potential for fraud. The borrowers -- I mean, this is a great opportunity for scan artists to come into that community and talk to borrowers into things that don't have anything to do with their housing. And especially since the contingency on the expanse of these funds is that they have to put a covenant on the property that they'll have flood insurance forever and forever, if these houses aren't going to be getting rebuilt, I mean this land will never get redeveloped if the fraud artists get their way. So we'd like to look at that.

And finally, financial education is something that's within our committee, and we would like to look at it this year. But we're actually going to be looking at it in a slightly different way. What problem is it we're trying to solve with financial education? And is financial education as we've all been approaching the most effective way to solve that? So there's some questions we'd like to wrestle with in the year to come.

CHAIRPERSON SWANSON: Great. Thank you.

Forrest, if you could give us an update on the Depository and Delivery Systems Committee?

MEMBER STANLEY: Yes. In addition to the two issues we discussed here today, we also had a discussion about Hurricane Katrina and there was a paper that was presented by two members from the Fed, one from the Philadelphia office and one from the New York office on the effect of Hurricane Katrina and the access to financial services. Part of that story was the success of stored-value cards. I mean, fraud's an issue, but it was a very effective means of getting funds in the hands of the people that needed it. And there will be, obviously, more discussion around that.

Going forward we have quite a few topics that we're carrying forward. FACT Act reg guidelines for identity theft. Storing of sensitive information on credit cards on the magnetic strip of credit cards.

One of the topics that we talked about last year but we'll probably look at closer this year is having -- whether we can get to a uniform consumer disclosure regardless of whether it's a debit product or a credit product.

Some emerging HCH issues. There's probably some more discussion around payroll cards and Reg E error resolution rules.

CHAIRPERSON SWANSON: Great. Thanks. Okay. We've got the Compliance and Community Reinvestment Committee. Anne, if you could update us on that?

MEMBER DIEDRICK: I'd be happy to.

We had a lot of guest speakers yesterday, so it was really an interesting afternoon.

First we had Jim Blaine from the State Employee Credit Union of North Carolina join us and he discussed a program that they offer in his credit union, which is an answer to payday lending and it's called the Salary Advance Program. It's a program that members can borrow up to $500 at a time at 12 percent APR, 1 percent a month and they are one month loans at one percent.

Astounding to me was that there were 56,000 members of the credit union who participate in this program, 80 percent use it on a recurring basis and that they have $20 million out in these loans to North Carolina employees. I think they should probably get paid more.

Then Dan Sokolov from the staff joined us and gave us a summary on the CRA Q&A results. And that discussion went far afield from where we started with Dan into an entire discussion on CRA rating and are they rigorous enough and the future of CRA and why anybody

even asked for an outstanding rating, whether there should be incentive, etcetera. So that discussion continues many, many years.

And then finally Stella Adams and Kelly Walsh both did a presentation on financial literacy programs.

For the June meeting we have -- or for the June meeting plus into the future, we have a long list of things and we know that there'll probably be some compliance issues in addition that will come up, but we have a lot of CRA issues that the committee wants to discuss.

We're going to continue next time if possible on our discussions. I will turn to banking services and new product innovation. We really only touched, scratched the surface yesterday. This is where we're focusing on the low- and moderate-income segment looking at unmet banking needs and doing more discussing around where the best products and services to serve this market beyond the payroll card.

We expect to have a discussion next time and be joined by Robin Praeger from the staff on a conversation on anti-competitive bank mergers to better understand what the process is in a merger, what the Fed and other federal agencies look for during an application process.

And then on the CRA front there's interest in having a discussion around the CRA services test and how it's evaluated in an examine, a look at the investment test and the range of investment opportunities that are out there, what banks are actually doing. And we didn't talk about risk and returns, but I would imagine that it will come up in that context.

And finally more on the CRA rating and fair lending and violations and if we're seeing anything new happening since the change in the regulation. I think it's probably too early.

So that is what we discussed as some topics for the future.

CHAIRPERSON SWANSON: Quite a few topics for the future.

And then finally Kurt on Consumer Credit.

MEMBER EGGERT: As far as what we discussed yesterday, you can get a taste of it because we discussed all of it today. We talked about home equity lending hearings and what should be the topics and approaches and that. We discussed nontraditional mortgage products. And also Truth in Lending and the new Bankruptcy amendments. And you heard us discuss it.

As far as what we'll talk about next time, one of the issues that I think will be coming up will be credit scores and trying to look at whether credit scores are actually predictive of the risk that financial institutions when they take on a borrower, actually reflect creditworthiness or

are there biases in the creation of credit scores that we should be concerned about. Biases that may account for some of the HMDA data results that we've seen.

We also will be talking about risk-based pricing notices that are required by the FACT Act and we're looking forward to whatever the FACT Act work that the Board does. There's a subpart to that, which is I think they're looking at some identity theft issues which we'll be discussing as well.

We also anticipate there will be additional issues in nontraditional credit, as this market continues to explode so will our heads as we try to define it and discuss it. And so we'll be flushing out those issues.

And another thing that we had talked about talking about was model draft disclosures for credit card solicitations.

So those are the topics that we have in front of us.

CHAIRPERSON SWANSON: Great. Thanks, Kurt.

Well, it looks like a great agenda for the future, and based on the updates, it looks like we'll have a great meeting in June as we did today, which is really exciting.

In closing, I just want to thank the Board staff for all of their hard work. You guys really put in a ton of work and really support us and do a great job at it, and I want to thank you for all your work.

And then, I also want to once again thank Chairman Bernanke and Governor Olson and Governor Warsh for your time and interest and participation on these issues.

That adjourns our public meeting. Just a couple of quick reminders as we're going to get our picture taken with the Governors now, and it'll be right over here on the other side of the room, in this room, and then following that, we'll have our lunch right down the hall to the left.

Thank you.

(Whereupon, at 1:00 p.m., the meeting was adjourned.)