TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING

THURSDAY, JUNE 22, 2006

The Consumer Advisory Council met at the offices of the Board of Governors of the Federal Reserve System, in Dining Room E, Terrace Level in the Martin Building at 20th and C Streets, N.W., Washington, D.C. 20551, at 9:00 a.m., Lori R. Swanson, Chair, presiding.

Members present:
Lori R. Swanson, Chair
Lisa Sodeika, Vice Chair
Stella Adams
Faith Anderson
Dorothy Bridges
Sheila Canavan
Carolyn Carter
Michael Cook
Donald S. Currie
Anne Diedrick
Hattie B. Dorsey
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
Alan White
Marva Williams

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

A G E N D A

P-R-O-C-E-E-D-I-N-G-S

9:03 a.m.

COUNCIL CHAIR SWANSON: Well, good morning. I want to welcome everyone back to our June Consumer Advisory Council meeting. And, in particular, I'd like to acknowledge the Governors who are in attendance: Chairman Bernanke, Governor Warsh, Governor Olson, and Governor Bies. I appreciate your being here and thank you and welcome.

Today, we've got a great agenda. Very interesting agenda. We had some great committee hearings yesterday.

The first three topics relate to the topic of home-equity lending, and really divided into three sub-sets from, what 9:15 to 10:15 we'll cover HOEPA Rules and the impact of HOEPA Rules.

Our second topic on home-equity lending will then be the Subprime Mortgage Market and specifically how consumers shop for credit.

And then our third topic on home-equity lending will be nontraditional mortgage products, and thereafter we'll shift gears and discuss financial literacy.

On the topic of home-equity lending, the first topic, the Federal Reserve Board is directed to hold public hearings periodically on the home-equity lending market and the adequacy of existing protections for consumers, particularly low-income consumers. And the Board has done that, held a series of public hearings on home-equity lending in the past couple of weeks taking place in Chicago, Philadelphia, and San Francisco with one more hearing taking place in Atlanta coming up.

So, that shifts us then to our first topic which is coming out of those hearing is the rules implementing HOEPA, and with that, I'd like to ask Mary Jane Seebach to tee off our discussion on that topic.

COUNCIL MEMBER SEEBACH: Thank you very much.

Good morning, everyone. As noted, the first area that we're going to talk about is actually the effect that we've had of changing the HOEPA rules several years ago.

The first issue that we're going to tee up is when the Fed amended the rules several years ago, they lowered the threshold for first lien loans. And I'd like to talk about what's the impact that's had on HOEPA coverage. Are we seeing more loans covered by HOEPA, or has it had the opposite effect.

And I'm going to start with Ed if that's okay.

COUNCIL MEMBER SIVAK: Good morning, and thank you, Mary Jane.

One of the things that I did in preparation for the meeting was to actually talk to some mortgage brokers who operate with different products and have networks of other brokers that engage both in the subprime market and in the prime market. And one of the things that they said in response to the question about the effectiveness of HOEPA was that seven, eight, nine years ago, one of the things that you would do is try to pack eight, ten points onto a loan. Since then they obviously can't do that, so they need to identify other ways to make their money.

One of the ways in which they do this is through schemes where they'll get contractors in place, they'll inflate the appraisal of the property, and set up essentially side deals whereby contractors will pay the brokers, the brokers will pay the appraisers, and it's abuse that goes on. And it's fairly widespread, and it's just another way of achieving the same outcome of maximizing the profit on this loan that in the end ends up hurting the borrower.

COUNCIL MEMBER SEEBACH: So, just to make sure I understand; so what you're identifying is that their loan amounts are being increased so that they can actually take the same dollar amount away. In other words, they've got a dollar threshold they're looking for.

COUNCIL MEMBER SIVAK: That's correct.

The borrower may approach a broker or a broker may approach a borrower and say, "Look, it looks like you need some siding on your house; what do you think about that? And how about a roof? I've got a couple of people over here that can help you out.

At the end of the day, what started as a $20,000 transaction is now a $50,000 transaction.

COUNCIL MEMBER SEEBACH: Anyone else want to comment about the impact? I think we know from the HMDA data, we're not seeing an awful lot of actual HOEPA loans. So, does anyone else want to comment on the impact of having the HOEPA threshold?

Stella?

COUNCIL MEMBER ADAMS: I think one thing the lowering of the threshold has done has reduced the overall rate, because people are avoiding the threshold. And so it had the impact of rate reduction or subpriming in high cost borrowers. So, I think that that was really important.

And I think where we can go looking in the future is maybe what is included in that trigger is where we can address some of the things that Ed talked about in terms of how, while it's flattened out the rates, they've found other ways of getting those points and fees that weren't included in the triggers.

But I think that's a really, you know, I think there's a beneficial effect that people aren't seeing in 10, 12 points in their loan.

And I think there are other ways, other opportunities in the discussion to deal with the things that Ed brought up that are current practice. But I think that it did have a beneficial effect in lowering the rate because the number of HOEPA loans have decreased because people have stayed under the trigger.

COUNCIL MEMBER SEEBACH: I think, you know, one of the questions is whether or not this has had an impact in limiting the amount of subprime credit available, and I would throw that out. I don't think it has.

So, are there other factors other than the HOEPA restrictions that have impacted the market?

Alan?

COUNCIL MEMBER WHITE: Yes. I think that when the predatory mortgage lending problem was identified, it really had two components. One was basically price gouging or, you know, economic rents, if you like, and the other was excessive risk. And I think HOEPA started a process very effectively of focusing on the price gouging, especially on the point and fee side. And I think one of the best things that happened was the focus on the single premium insurance product, which was a product that provided no consumer welfare as far as I'm concerned. And it's pretty much gone, and I don't think anybody misses it.

And I want to relate the experience of one of my clients who really illustrates the changes in the market and how HOEPA has affected that. I have a client who got a subprime loan in 1998, and then just came back to me sadly with one she just got three months ago in 2006.

The same person got a HOEPA loan in 1998; it was 10 points at least that the broker received. But it was a fixed-rate mortgage for $15,000 with a payment she could afford. Now, it was utterly pointless because she didn't get any cash out of it. But, putting that aside; I got her out of that deal, and she came back to me with a loan that I think is very typical of the predatory subprime loan of 2006, incidentally, from a large money center bank, but arranged by a broker, which was for $35,000, considerably in excess of I think the value of her home. It's an adjustable-rate loan and has a pre-payment penalty. It's a no income documentation loan. It would have to be, because her income is $600 a month and the payments are $400, and that's principal and interest only, not counting taxes and insurance.

But the fees, I think, were about 3 percent, and the rate, actually, was considerably lower than the 1998 loan. So, I think both the point and fees have compressed, partly because of HOEPA, partly I think because of state laws. And my experience is -- and Pennsylvania does not have a mini-HOEPA law goes beyond the Federal statute. But my experience is that most of the lenders are staying not only under the eight-point trigger, but under the five-point trigger that a lot of states have established. And that's kind of become the new de facto standard, which is a good development.

I don't see that my clients are, who got HOEPA loans in the late '90s are now unable to get home-equity loans or first mortgage refinancings. They're just getting loans that have different characteristics. So, you know, usury loans are sometimes thought of constraining the supply of credit, but I think there was so much slack, so much excess in the pricing in the late '90s that the laws have very effectively -- the laws and best practices and what the Government-sponsored enterprises have done with their policies, have really put the pressure on points and fees.

But now, the real problem to me is one of risk, and all these layers of risk that people are taking is leading to a huge increase in foreclosures, and it's risk that isn't well understood, I don't think, by consumers or by the capital markets.

COUNCIL MEMBER SEEBACH: Faith.

COUNCIL MEMBER SCHWARTZ: Yes. I agree with a lot of what Alan said. I think back in '98, or pre-HOEPA adjustment with the triggers being adjusted by the Federal Reserve, it's quite a different market today. And, of course, as we keep breathing, it's 25, or even in excess of 25 percent of the residential lending market. Thus, there's no players, there's more capital in the market, and more efficiency coming in. There's still some issues with the types of loans and risk layering, of course, but it is a very different market today than it's been just five years ago. And you're just looking at 25 states with new laws, with very different

HOEPA triggers in each one of them, that don't mirror the Federal HOEPA definitions. So, it's a pretty different landscape today than it was not many years back.

COUNCIL MEMBER SEEBACH: Can I just go on? The trigger for junior liens was not lowered, and is there any comment on the impact that's had on junior lien loans, or whether or not it's appropriate at this point to change that or address it, or, any thoughts on that?

COUNCIL MEMBER ADAMS: I haven't seen a second mortgage in, I can't remember when.

I guess the question is, what happened to second mortgages?

COUNCIL MEMBER SEEBACH: Interesting.

Alan.

COUNCIL MEMBER WHITE: Yes. I agree with Stella that it's a necessary product that the market is not delivering. I don't think whether, you know, what the HOEPA trigger is is that critical in the availability or non availability of second mortgages and home-equity lines of credit, but I think it's something that ought to be thought about.

COUNCIL MEMBER SEEBACH: Well, isn't the issue with junior liens is they're usually a much smaller loan amount and, therefore, the ability -- obviously, there's usually a higher interest rate and higher points. So, those probably would be much more likely to be HOEPA loans. Maybe lenders are not making those loans because they don't want to have the HOEPA loans? Is that a possibility?

COUNCIL MEMBER WHITE: I think so, and I think also that, comparatively, they are made to look a lot worse because of the interest rate. But I think there's such an information problem in the first mortgage side of the market, especially in the subprime side, that, systematically people are, you know, being steered to cash out refinancings because, superficially, they might be made to look better, but in a lot of instances they are not a better product. And, you know, maybe if you correct some of the information problem on the first mortgage side, that balance might change.

COUNCIL MEMBER SEEBACH: All right. I'm going to go on.

Some of the rules that are in the HOEPA section really pertain only to HOEPA loans. For example, the restrictions on flipping, restrictions on requiring that you document the borrower's ability to repay and, of course, the prepayment penalty restrictions.

I'm going to open it up as a general matter, because, as we said, there are definitely less HOEPA loans now that we're seeing. But if anyone would like to address how the Board has treated those restrictions, or thinks they should re-treat those restrictions going forward.

Stella.

COUNCIL MEMBER ADAMS: This is one of those critical things for me.

I think that the definition of flipping that is in the HOEPA is great, but there are not a whole lot of HOEPA loans. And so what I think I'd like to see the Board do is take that definition of flipping, and adjust it, and say that it's an abuse. A lot of states, under their anti-predatory lending laws, have adopted some anti-flipping provisions. Maybe look at those provisions that have been adopted by the states that seem consistent with the HOEPA language, and are fairly consistent amongst the states that have anti-flipping provisions, and just declare it an abusive practice under that authority of the HOEPA, so that it goes to all loans and all lenders, and not just HOEPA loans.

COUNCIL MEMBER SEEBACH: Are there any particular examples? I assume you're going to say North Carolina, but --

COUNCIL MEMBER ADAMS: Yes. But there are other -- I mean, there are lots of other places. Of course, look to North Carolina first. But, again, I'm not uncomfortable with the language that is in the HOEPA currently. Just broaden it to include all loans.

COUNCIL MEMBER SEEBACH: Any other comments on that?

Hattie.

COUNCIL MEMBER DORSEY: I might just add to what Stella said. I know that, in Georgia, we had a fairly strong predatory lending policy adopted by the state, and a year later it was overturned or reduced.

And I asked the question yesterday in one of our meetings; what happens when a property, or a bunch of properties in a certain neighborhood gets flipped to the point that they're not financeable? They're past the value, and they add to the decay of a neighborhood by nobody buying them anymore.

I know that one of our council members, city council members, is going to take this on with reference to mortgage fraud and how, in fact, that happened.

And Anne indicated that, at Chase, they have the software that takes a look at the history of how many times a house has been flipped. I don't know if that's available to the industry or what, but I would say to you that, at the other end of the spectrum is a point as to where the neighborhood has a path of decline based on the enormous amount of properties that are left.

And I also asked the question, how does the bank recover its value, its money, when they have been the last lender in?

COUNCIL MEMBER SEEBACH: Does anyone want to respond?

Faith.

COUNCIL MEMBER SCHWARTZ: Well, they don't. And so, you know, flipping what happens with Atlanta, I think nationally that made big news with a woman who monitored the neighborhood and saw houses change and appreciate rapidly. But no lender benefits from rapid flipping where there's a false appreciation of housing. So, it seems to be, there should be an area explored there for preserving value of neighborhoods and not having inflated values across the mortgage spectrum.

COUNCIL MEMBER SEEBACH: I think one of the issues that certainly came up in our discussions yesterday, and I think it's one of the sources of frustration for most lenders as we go in and talk about state predatory lending, or even Federal predatory lending, is that the underlying cause for so much of predatory lending, abusive lending, whatever, is fraud. Either fraud in the appraisal process, or fraud in some other documentation process.

Are there any thoughts or recommendations on, I mean, it's very hard to legislate that outside of the existing laws which prohibit fraud at both the state and Federal level.

What does the addition of the HOEPA restrictions, what else does that add to this when it doesn't really seem to get to the root cause?

Carolyn.

COUNCIL MEMBER CARTER: One thing that HOEPA adds is remedies. In many states, the State Deceptive Practices Act does not apply to credit, or does not apply to regulated entities, licensed entities, chartered entities, which means that, in those states, unless a consumer can meet the higher standard of proving common-law fraud, the consumer may not have a remedy for the sorts of practices we're talking about.

But amendments to Regulation Z at least had the potential of giving the consumer remedies that are available under the Truth in Lending Act. And it may be that, on a macro level, attorneys general and the bank supervisors can enforce -- they can enforce standards, even if the consumer doesn't have an individual ability to enforce the standards. But if the consumer himself or herself can enforce the standards, that means that the consumer is in danger of losing the house, even though there has been -- even though there have been deceptive practices that are causing the consumer to lose the house.

And I would echo what Stella said about expanding the practices that are prohibited under HOEPA to expand them to more than just HOEPA loans. Your Regulation 226.34 already does prohibit a few practices in the mortgage market, generally. And I assume that was adopted under your general authority under HOEPA to prohibit deceptive and abusive and unfair practices in the mortgage market, generally.

And I urge the Board to take a very serious look at 226.34, and consider expanding that to prohibit more of the practices that we're talking about.

COUNCIL MEMBER SEEBACH: Anne.

COUNCIL MEMBER DIEDRICK: I don't pretend to know nearly as much as Carolyn. I'm not a lawyer. I don't work at our mortgage company. But I'm not so sure I could agree with this idea of taking the HOEPA rules and applying them to all mortgages, all types of mortgages that are done today, including all the prime mortgages.

And if I understand the HOEPA flipping provision, it really is to prevent a lender, let's say in this case Chase, from refinancing its customers' loans the same year that it had already made the loan. So, if the interest rate drops halfway through the year, my borrower comes back and wants to refinance, I have to say, "Sorry. Why don't you go over to Citibank. They can do it for you; I can't do it under this rule."

It just seems that there were reasons for putting very strict rules in place for the higher cost loans, the HOEPA loans. Very high-cost loans of which there are very few today. There are serious reasons for doing that, but to take those reasons and apply them to everybody at this table and everybody in the country who is a prime borrower seems crazy to me.

COUNCIL MEMBER SEEBACH: Faith.

COUNCIL MEMBER SCHWARTZ: Yes. I'd agree with Anne on that issue, and I think the flipping that was discussed earlier with Hattie is a little more on property changing from owners, and there should be a fraud prevention effort in the industry to prevent that inflated. But that's different than refinancing in a lower rate environment in your own option to refinance. I think borrowers do have the right to do that, and that's been happening across the country in the last ten years.

COUNCIL MEMBER SEEBACH: So, I just want to pick -- sorry, Stella.

COUNCIL MEMBER ADAMS: Again, even with the refinances within a year, there are states that have anti-loan flipping provisions that apply to all loans.

What I would suggest is that there is a way to do this that preserves the right of the borrower and of the lender to retain that borrower, but at the same time puts in safeguards. And so maybe it's not lifting it verbatim from the HOEPA standard, but a lot of states have adopted a net tangible benefits test, or some other type of test to make sure that, if the loan is refinanced within the year, that there's some benefit to the borrower. And perhaps that type of test is why I originally suggested not just looking at the existing provision in HOEPA, but also looking to the states who have done amazing innovation in protecting.

I don't think there's a need to reinvent what the abuses are. I think the states' attorneys general have done a great service in the last five years in the big settlements and best practices agreements that they have come up with in defining what is an abuse and what is a best practice. And I don't know that we need to have the Board reinvent. Just take from what the marketplace has produced, and what the marketplace, through our states's attorney generals, has defined as abuses, and has settled and said, this is abuse, and this the correction for it. And then adopt those best practices, or adopt those things that the states' attorneys general has defined as abuses, and put them in the abuse section.

But it doesn't have to be verbatim what is in HOEPA. I agree that might have significant impact on prime borrowers. But putting some type of benefits test to make sure that it does benefit the borrower to have that, because, you know, if it's a 1/4 point reduction in interest rate, and you pay 3 points to refinance, I don't know that you benefit from that.

But, you know, I'm saying there should be some Federal legislation.

COUNCIL MEMBER SEEBACH: Thanks. Alan.

COUNCIL MEMBER WHITE: A couple of points. I do think that it is very important. There's an important role for Federal regulation to take some of these, both best practice standards and state standards, and make them a national floor because of the experience we had in Georgia that Hattie referred to is an excellent example where a state tried to push a little farther in regulating predatory lending, and maybe too far, arguably. But you have the problem of this kind of auction system when the regulation is done state by state where the lenders have the power to basically threaten to pull out of a state, which is exactly what happened.

There were letters from the bond rating agencies to state legislators, and maybe the governor, I don't remember, saying, basically, we need you to rewrite the law, or there won't be any mortgages in Georgia. I mean, it was economic blackmail.

And to the extent you can find policies that are effective, and that don't unduly constrain credit, there's a tremendous advantage to doing them, obviously, at the national level.

COUNCIL MEMBER SEEBACH: Hattie.

COUNCIL MEMBER DORSEY: Can I add to that?

There is, I think, if you look at what was said in, I think, USA Today two days ago, where they showed a heavy number of foreclosures really on the southeastern line that included Georgia and some of the other southern states. There is something real wrong with reference to it all being centered on this side of the country. And that, perhaps because of the fact that the southern belt has a lot of low-income populations, and the salaries don't match the mortgages, that there is, I think, a key and prime market for subprime lending, and the other kind of abuses that take place through the lending industry.

And we'll get into that later on, I know in a conversation around financial literacy and all. But I do think that you need to take a look at where the abuses are strong. And they happen to be very strong in this section of the country. And something is wrong there. And I don't know that HOEPA and all the other laws that we are pushing govern and override some of the state policies.

COUNCIL MEMBER SEEBACH: Mark.

COUNCIL MEMBER METZ: I guess, following up on Alan's point, as a national lender, we would be very much in favor of national standards.

I think the problem is, the Fed cannot get at everybody. And it's probably the folks that they cannot regulate are probably the abusers. But as a general proposition, we would very much be in favor of that as a level playing field.

COUNCIL MEMBER SEEBACH: Okay. I was just going to tie the thread together, and then I'll turn it over. But, you know, we started with Ed's talking about inflating loan amounts to make sure that we could take the same return. We're talking about the disappearance of, I mean, anecdotally now, obviously, the disappearance of junior lien credits, so smaller loan amounts. We're talking about flipping, which is inflated -- usually involving inflated appraisal amounts as these things flip over. We're generally into an area where the Fed can't regulate appraisers, and that sort of thing. And that is problematic, but it is a very common thread that a lot of us have seen in a lot of these local markets, and that neither Federal nor state legislation really address, and it is a concern as we move forward.

Carolyn.

COUNCIL MEMBER CARTER: Mark said that the Fed can't reach all abusers. And the Fed may not -- I think it's questionable whether the Fed can reach appraisers. I would argue that they can under the general authority to prohibit abuses in the mortgage market. That's very broad authority in your HOEPA statute. But it's perfectly clear that the Fed can regulate all lenders, whether they're Federally supervised or not.

And, in fact, you have exercised that authority under Regulation 226.34.

I also wanted to say one more thing about the HOEPA practices. I'm not advocating that you should just take the HOEPA prohibitions and apply them unthinkingly to all mortgages. That would clearly be inappropriate. But what I am favoring is, as Stella said, looking at those prohibitions, looking at the abuses in the market that doesn't meet the HOEPA triggers, and making appropriate probe -- using your authority under the HOEPA to prohibit abusive and unfair practices in that part of the market.

COUNCIL MEMBER SEEBACH: Governor Bies.

GOVERNOR BIES: I just wanted to see if somebody can give me some feedback on some initiatives I think touch on what you're describing. The issue that we can put things in place through Reg Z, but then what happens in the real world where we don't have direct supervision?

The Conference of State Banks Supervisors, as you know, really has licenses, the mortgage brokers in most states. Not all states, but they and the National Association of Appraisers are launching, for the first time, a registry of mortgage lenders which has never existed before. Because one of the things they found is, if they take action against a broker because they've not done things according to state law or any other regulation, that they can turn and modify their names slightly, do business under a different name, and set up shop and get going again. So, this would, for the first time, try to get a national registry. And part of this was, they’re seeing this flipping, and a lot of fraudulent loan. As you know, loan frauds reported through SARs have tripled in the last three years. So, there’s a lot more activity. But the increase of frauds has gotten very, very serious.

But I think there’s -- last I heard I think there’s 18 states that have signed up on this registry. But I think as that goes forward that it would be helpful to get your input.

The other, as you know, the Federal bank regulators do have an appraisal subcommittee where we do, as part of our exam process, set some standards where we look at appraisers as part of the examination of loans that have passed through federally chartered institutions, or supervised institutions.

But there are some new appraisal standards going into effect this year that are radically different in many ways. You get to specify what kind of appraisal you want in a different way. And we’ve been working very hard at it in the FFIEC Appraisal Subcommittee. But, again, if there is some unintended things happening there as these new standards go into effect, let us know. The idea was, this would be further strengthening.

As you know, we came in after the abuses of the ‘80s and really strengthened the appraisal oversight. This is a major national change in the standards that appraisers will use.

But if you just keep your eyes and ears open for that, that would be helpful to us, too.

COUNCIL MEMBER SEEBACH: Okay. Thank you.

All right. Let’s have some discussion about prepayment penalties.

As I noted, the restrictions on prepayment penalties in HOEPA are limited to HOEPA loans. But, I’m going to open it up and see if there were any discussion about any additional disclosure requirements that people feel are necessary for prepayment penalties or other restrictions.

Stella.

COUNCIL MEMBER ADAMS: I think one of the things we’d like to see is that prepayment penalties, especially on ARMs, do not exceed the fixed period of the loan. And maybe that it go more to where the market is now. It’s not five years really active in the marketplace; it’s more like three. Maybe to change it in that way.

COUNCIL MEMBER SEEBACH: Anyone else?

Alan.

COUNCIL MEMBER WHITE: The comment I think has been made before. But the Reg Z disclosures are particularly useless on prepayment penalties. And I would maybe make this sort of more general point that prepayment penalties are one of the layers of risk I see in subprime mortgages, and adjustable rates and increasing payments is another one. Both of those items: prepayment penalty and adjustable rate, which are contingent price elements, are not at all disclosed on the current Reg Z form. And I think Carolyn mentioned this at the last session, but I think it would be worth thinking about doing a regulation before you complete the whole closed-end credit review, which is going to take a little while, just to look at those two points. And I think consumers really need a worst-case scenario disclosure. Because we can rely on the sales people to tout all the benefits of various kinds of loan products.

The response you frequently get when you advocate worst-case scenario disclosure, you know, you might have to pay as much as $5,000 if you prepay your loan. That would be an example. The response we get is, oh, that's unrealistic. That's, you know, a highly contingent event. Well, you know, that can be explained, and I'm sure it will be explained, by the sales force. But I think when you're talking about risk, the best way for a consumer to understand risk is to see the worst-case scenario.

COUNCIL MEMBER SEEBACH: Faith.

COUNCIL MEMBER SCHWARTZ: I think Alan has a good point. Prepayment penalties are a complex part of the market in this segment.

One thing Option One has done to get at that is, years ago we matched the duration of the ARM with the prepayment penalty so they didn't get trapped into that prior adjustable-rate loan, wanting to refinance, and then having to pay a prepayment penalty. That's just an obvious one. I don't know that the market is quite fair, but I think there are a lot of players that do do that. We also have a front-end plain language disclosure. Very simple, but one of the first things they see, and in it, driving toward the worst-case scenario; if you prepay your loan tomorrow after you get it today, this is what it will cost you to cash out.

So, getting to your point. I don't know that it's a silver bullet, but it's something that will help clarify to the transparency to the borrower on what they're getting. And hopefully getting a benefit at a lower rate with having a prepay penalty, because that's how they're priced.

COUNCIL MEMBER SEEBACH: Thank you.

Forrest.

COUNCIL MEMBER STANLEY: Yes. I would just like to reinforce Faith's comment.

I think most responsible lenders who offer products that have prepayment penalties also offer products that don't have prepayment penalties, and it is a function of price.

It's interesting, we've had this conversation before around this table that the disclosures that are currently out there today and required by Truth in Lending, which do require disclosure of the prepayment penalty aren't effective.

And I think most lenders, including the one that I represent, do have an additional voluntary disclosure that says, you know, this product has a prepayment penalty; here's the term of it. And we offer products without prepayment penalties. So, we are making them aware of the fact that they have alternatives.

But I think we keep coming back to the fact that we, you know, keep talking about -- we have disclosures now of disclosures. And the underlying problem, of course, is that the disclosures are so complicated, that they're very difficult for the average consumer to understand. And whatever the problem is de jure, we always say, well, that disclosure is ineffective.

I mean, I think the bigger problem is we're trying to do too much with the disclosures. And if we get it back down to kind of a more simpler scheme, I think the disclosures by and large would be more effective for all products and all issues.

COUNCIL MEMBER SEEBACH: Ed, and then Carolyn.

COUNCIL MEMBER SIVAK: I want to echo Faith's comments about setting the prepayment penalty to the term of where the loan would adjust.

In conversations with a broker, they'll still tell you that two of their most popular products are the 2/28 loan and the 3/27 loan, where after two years the rate will adjust, or there will be a balloon note.

Two years, three years is ample time to demonstrate sufficient history of payments. And what I would suggest -- and, again, the prepayment penalty is a necessary tool to sell those loans on the capital markets, as well. That's what some people will say.

However, once it crosses over; if you block someone into having to face that balloon note with a prepayment penalty, having to face the adjustable with the prepayment penalty, why not limit those prepayment penalties to the term of the loan up until it adjusts, up until it balloons?

COUNCIL MEMBER SEEBACH: Thank you. Carolyn.

COUNCIL MEMBER CARTER: I want to say that I couldn't agree more with what Forrest said.

Disclosures alone are completely insufficient for consumers to be able to protect themselves with these complex products. Maybe if we're talking about an old-fashioned department store installment sale where there's a simple payment schedule and a simple rate of interest that doesn't change over time, the Truth in Lending disclosures alone might be sufficient to enable consumers to shop for credit and to protect themselves.

But with today's complex mortgages, and the huge number of permutations and combinations of terms, there's no way that disclosure alone is sufficient. And that's why we urge the Board to go beyond disclosure, and to use its authority to prohibit unfair practices.

COUNCIL MEMBER SEEBACH: Thank you.

Governor Olson.

GOVERNOR OLSON: I'd like to ask a question on this subject to both the lenders and some of the community people.

On the length between prepayments and pricing, I remember the days when all loans were assumable on sale of the property, which is to say that they were not doing, at the time, that they were assumable by the -- on sale of the property, and not callable at the end point.

We went from that environment, which had a very chilling effect, particularly in the rising interest rate environment, to limiting that provision, but making all loans -- but allowing prepayments, which is essentially a single-sided option. A very positive option for the borrower, and a very attractive feature of the loan.

But with the development of the secondary market, that created some hedging issues. And in an environment like today where dynamic hedging is an important part of funding, the lending, presumably, there ought to be a link between prepayments where you eliminate that prepayment risk, or you limit the hedging exposure and the pricing of that loan, either in the rate or the fees.

And I'm just interested to see whether or not, in the market, that is, in fact, the case. If there is a link between pricing and the prepayment option, because that, in fact, would --

that, in fact, would address some of those issues.

COUNCIL MEMBER SEEBACH: Alan, and then Anne.

COUNCIL MEMBER WHITE: Well, I know of one empirical study on that subject by the Center for Responsible Lending that found that there was not, when you looked at actual prices of actual mortgages.

Certainly, when you look at rate sheets, there is a trade off. And the question of how you get from the rate sheets, which are mostly wholesale pricing, to what the consumers are paying, is kind of interesting and fascinating.

The other kind of natural experiment evidence we have is that prepayment penalties are illegal in some states. In my state, Pennsylvania, they're illegal for mortgages less than $50,000.

New Jersey, I think, they're illegal, and you can look at rate sheets that lenders have to see the difference, even in their wholesale pricing, from state to state. And to some extent, there are differences, but they're, typically, 50, 75 basis points. And somehow, between the wholesale side and retail side, they seem to wash out entirely. And that's my experience.

I think prepayment penalties bring down the wholesale price a little bit. I think that just gives the brokers an opportunity to make a little extra margin.

COUNCIL MEMBER SEEBACH: Let me just say, countrywide, definitely, especially on the non-prime side, there is absolutely a corresponding reduction in rate and points with a prepayment penalty. And those are structured for the various products, and disclosed.

We also give a disclosure to the borrower if they're going with a prepayment penalty product that they can get a non-prepayment penalty product, but it will have a higher rate and points.

Anne.

COUNCIL MEMBER DIEDRICK: That's exactly what I was going to say about Chase.

COUNCIL MEMBER SEEBACH: Faith.

COUNCIL MEMBER ANDERSON: I would agree with your comments. I mean, we have corresponding rate and pass-throughs to the investors in the advent of securitization. In the still young market, prepayment penalties really helped bring rates far down to get rid of some of the uncertainty on the prepayment side, which had been very volatile.

That's really why they became part of the market. And how they're used is still complex at the front end, and I think it's something to look at. But they clearly show the economic benefits. And there are several studies that will show that, as well.

COUNCIL MEMBER SEEBACH: Alan.

COUNCIL MEMBER WHITE: I just want to say something about these voluntary disclosures, because I've seen these, certainly; my clients bring them to me.

So we have the Truth in Lending form. And what it says is, your loan may have a prepayment penalty. That's what it says. And there is a prepayment penalty. It says your loan may have a prepayment penalty, so that's useless information.

And then you get the voluntary disclosure. And the one I saw recently with, you know, a Wells Fargo loan -- I'll pick on them since they're not here -- said, your loan will have a prepayment fee feature. And if you choose not to have the prepayment fee, you may get a lower interest rate. There's no numbers associated with this, and I liked the use of the word "fee" to substitute for penalty because it sounds, you know, a little less dramatic and large.

And this is a separate piece of paper that's included in probably a dozen or so forms that are signed, including the one about transfer of servicing and various other, you know, affiliated business disclosures, and all these forms that really provide very marginal useful information.

So, the fact that it's separate from the main price disclosure, and the fact that the main price disclosure doesn't give good prepayment penalty information, I think makes it so that most consumers really can't be aware of that trade-off, much less take advantage of it.

And I think the trade-off is there in the capital market at the wholesale level; I don't see it at the retail level.

COUNCIL MEMBER SEEBACH: Forrest.

COUNCIL MEMBER STANLEY: Governor, if I understand your question, I mean, our pricing models do take into account prepayment risk, and that's factored in both for a loan that has a prepayment penalty and not a prepayment penalty. I mean, all those factors are factored in.

GOVERNOR OLSON: Just to clarify, if you reduce the prepayment risk exposure, that should reduce the price either in the rate or the fee?

COUNCIL MEMBER STANLEY: Yes.

COUNCIL MEMBER SEEBACH: Yes. Anybody else?

I was just going to note. I don't think there's anyone here who is doing HOEPA lending. So, one of the questions that we were going to talk about was compliance burdens associated with the HOEPA rules, but I don't think there's a lot of discussion on that one, since nobody's doing it.

So, let me move on to -- are there any new practices that have developed since 2002 that -- and I think we've already started to allude to this -- but is there anything else that wants to be enumerated here that you think that the Board should be considering in this rule-making practice? Specific practices?

Stella.

COUNCIL MEMBER ADAMS: Along with the work that some of us talked about on the appraisal standards with the FFIEC, I think that's critically important on the nationwide scale.

Now that the mortgage lending market has changed to where the majority of the loans are not -- the contact with the borrower is not direct lender/borrower relationship, but through a broker, there needs to some visionary expansion of, you know, thinking about the authority that the Board has to regulate under Reg Z abusive practices in the mortgage market in a way that includes brokers. Because it's not -- 18 states are participating in the --

GOVERNOR BIES: So far. They have hopes for more.

COUNCIL MEMBER ADAMS: I will tell you that I'm pretty sure my bank supervisor is one of them, but in the south, in general, that's probably not the case.

And with the kinds of abuses that people are going to see happening to them as a result -- we are going to talk about this, I assume in October with Katrina, the abuses that are going to take place as people try to rebuild, the stuff the brokers are cooking up for that region without protections -- we've got to figure out a way to make the brokers who are now responsible for about 70 percent of production, they can't be out there renegading with that much production in their hands. And there's got to be a way to use the authority to define abuse under the Reg to reign them in.

COUNCIL MEMBER SEEBACH: Thank you.

Forrest.

COUNCIL MEMBER STANLEY: I just -- one comment to Stella.

I don't think it's necessary to put all of that in Truth in Lending, although if you put it in Truth in Lending, it would obviously pick up brokerage, which is something that is near and dear to our heart.

But the regulatory agencies -- each of them currently have the authority under Section 5 of the FTC Act to regulate unfair and deceptive practices against banks, and that is an authority that they have used, and there have been some significant penalties that have been assessed against banks.

So, there is some authority out there. I certainly agree that I would want the broker regulated for an unfair and deceptive practice, but I just want you to know the banks currently are regulated entities currently are subject to unfair and deceptive practice enforcement from the regulators.

COUNCIL MEMBER SEEBACH: Thank you. Sheila.

COUNCIL MEMBER CANAVAN: In terms of something new. On the way down here, I was listening to XM radio as I was driving to the airport.

To tell you the truth, I'm not sure if I heard this public service announcement by Bankrate.com accurately, or if maybe having listened to it, I fell asleep on the plane and it was a nightmare.

But what I heard them say, and I really listen to those because I like, you know, a lot of the public service announcements that they do. And I direct my kids to their web site.

But in any event, if I heard correctly, what I heard was, I think this ad was directed towards sellers of homes.

Think about increasing the price that you're asking for your home. And at the closing, you can give cash back to the person who is buying your home to cover their closing costs. And your neighbors will thank you for increasing their property values.

COUNCIL MEMBER SEEBACH: Alan.

COUNCIL MEMBER WHITE: On your question about new abuses or features in the market, and this relates to the fraud problem, is the growth of no doc, stated-income, alternate income loans. I would say that every one of my clients who has a loan made in the last two or three years has a stated-income loan. Of course, they are all loans that are in default, by and large.

But going beyond the anecdotal, I saw a report from Fitch that, of all the subprime mortgage securitizations they did in 2005, 40 percent of the loans in those securitizations were less than full income documentation.

Now, when 40 percent of your loans are stated income, I can't believe those are all appropriate, suitable uses of that product, and I think, when you talk about there being a lot of fraud, that's an open invitation by the market and by lenders to fraud. And I think the guidance on nontraditional products mentions this problem, and I think that might be, you know, expanding on that might be a good way to deal with the problem. But that's clearly an emerging problem, and I think fraud risk, to some extent, instead of lenders in the market focusing on stamping out fraud, they've just priced it.

COUNCIL MEMBER SEEBACH: Acknowledging Carolyn's point about, you know, actually addressing abusive practices, but short of that, in terms of enhancing disclosures, when we talked about maybe enhancing on the credit disclosure itself, the prepayment disclosure, whether or not you're actually going to get a savings in rate or points. Maybe that there are other things that might impact the price you're getting that the borrower needs to understand they're going into.

For example, you are getting a no doc loan. That means you're paying more for this loan. There are other options. I mean, are those things that folks would recommend, or would consider, or are there other features that you think the Board should consider trying to address that might impact price that would be a flag to borrowers?

COUNCIL MEMBER SEEBACH: All right. Okay. Let's see, the --

MS. BRAUNSTEIN: Mary Jane, I'm sorry. Can I just --

COUNCIL MEMBER SEEBACH: Thank you, Sandy.

MS. BRAUNSTEIN: -- make a comment. Thank you so much.

Just to say that, you know, we've done as the Council members know, we've done three hearings on these issues out in Chicago, Philadelphia, and San Francisco at this point. And it was interesting, the question you were asking, because that wasn't the concern we heard at the hearings about the stated-income loans. It wasn't the price issue. It wasn't around the price issue. What we were hearing was more along the lines, I think, that Alan was getting at, was that there were concerns that the income that was being recorded was not accurate --

COUNCIL MEMBER SEEBACH: Right.

MS. BRAUNSTEIN: –- and, in fact, was overstated in most cases in order to qualify people for loans that they probably shouldn't be getting. And that there were concerns as to how much of that, and that was still unclear, was driven by the consumer overstating their income, and how much of that was driven by, in most cases a broker saying, well, if we raise your income, you can qualify for this better house --

COUNCIL MEMBER SEEBACH: Right.

MS. BRAUNSTEIN: And nobody has to know, "wink, wink." Or even in some cases where the consumer didn't know their income was overstated and found out later when they got in trouble and ended up in Alan's office or somewhere that they looked at their paperwork and found that the broker had written in a number that they said they didn't even know the broker had written in. But those were the concerns that there was --

COUNCIL MEMBER SEEBACH: Absolutely.

MS. BRAUNSTEIN: -- a price consideration with the stated income or --

COUNCIL MEMBER SEEBACH: Well, it's interesting because I know Sheila raised this in the past that borrowers are often presented that that -- in other words, I don't need to know your income. We'll just go with this. Roughly give me a number, and I'll go –- and the borrower not having any clue that if they had actually provided a W2 or gone the next step, they could have gotten a lower rate; they could have gotten better.

So, I hear what you're saying, and there is a practice there that maybe needs to be addressed. But there's also a disclosure issue that's impacting price. For most lenders, that is a feature that's offered at an increased price.

So, Hattie.

COUNCIL MEMBER DORSEY: You know, I was just sitting here thinking, and I would pose this question:

If the subprime lender is dependent on the broker community to bring the loan to them, are then the broker community the ones that we ought to be paying stricter attention to, because they're the first point of entry, and particularly with reference to the low- and moderate-income first-time home buyer, that most of these loans are going to go through them. And they're going to end up in the bank's subprime lending group in order to get a loan.

And so I'm just asking, maybe the brokerage community ought to be the point that gets a lot of scrutiny.

COUNCIL MEMBER SEEBACH: Faith and then Lori.

COUNCIL MEMBER SCHWARTZ: One thing we've done, I think the stated-income fraud issue, especially if the consumer doesn't know they got a stated-income loan, is probably one of the worst ends of what could happen on a stated-income loan.

To mitigate that, and not knowing what the broker has done at the pont of sale, we've re-disclosed now on stated income loans in very plain language, first thing they see at the time we get an application is, you have elected to take a stated-income loan.

Again, it doesn't answer all the questions, but it does get that one element where the borrower may not know what's been written after the fact. And, of course, the wholesalers don't know that. And that's one way to mitigate it.

Another is to put into your guidelines policies and procedures that say no fixed income borrowers, you know, can get a stated-income loan. And there are various guidelines that will flow through to the broker community that at least are originated, hopefully, to those standards.

COUNCIL MEMBER DORSEY: Mary Jane, I am on an advisory board for a bank, and I know that this was the first time I heard this, and perhaps I was sleeping through some of the other meetings. But there's a way of bringing a borrower to the table on what we discussed yesterday on the teaser rates. And I found this practice just really just blew my mind is that you come in and you qualify at the really low rate. And that's what many people look at is getting you qualified.

And that teaser rate is so low, but that's for two years. Now, that person's income is not going to change significantly in two years.

What happens when the 28-year ARMs kick in? And that's where I think the foreclosures begin to escalate at that particular point in time, because you know the interest rate might -- they might have a clause in there that it's going to go up 5 percent. And if it goes up 5 percent, most of those folks are out of luck.

And I don't know that the banks themselves are advising the customer. All they want to do is to make the loan at that particular point in time. And it becomes an unfair practice from my point of view.

COUNCIL MEMBER SEEBACH: Lori.

COUNCIL CHAIR SWANSON: Yes. To comment on the stated-income issue. From my perspective, it's really a substantive issue more than a disclosure issue.

I think there are certain borrowers where a stated-income loan may be an appropriate loan. Their income is intermittent and, you know, they are a high-income person. But you'd have the stated-income or no documentation loan to qualify.

In other cases, though, there have been real problems with people being put into stated-income loans because the broker either flat out falsifies their income, or convinces a consumer that it's okay to do so in order to qualify them for a particular product.

And Minnesota was the lead state on a major national investigation of a large national lender. And stated incomes was one of the lead problems that we saw. And we had one couple, for instance, in Minnesota. The lady was in her 70s. The husband was in his mid-80s. The broker put down that the guy in the mid-80s made $2,500 a month building bird houses, and that the lady in the 70s made a couple grand a month cleaning houses. And that was simply not the case.

And what those were were not first mortgages or purchase money mortgages, but they were refinancings. And from my perspective, a lot of the stated-income problems have been lenders approaching the borrower, and essentially what in the insurance industry we call churning, getting them to refinance a product that's not suitable, and getting them to qualify for that refinancing by either falsifying their income or, again, convincing the consumer that it's okay to, somehow everybody does it and it's okay to participate in that. In our settlement, one of the things we did to address that is required an independent closing. And at the closing having the closer confirm with the borrower that they really did make that money, that they really did make $2,500 a month building bird houses, and confirming that so that if the broker is out there either faking it or leading the consumer to believe it's okay to fake it, that that problem is addressed.

I think, you know, blaming the brokers alone I don't think is enough. I think that lenders can do things to detect these problems.

When you have people in their 70s or 80s and a lot of the fraud and abuse we've seen with regard to stated-income has been the elderly, that there should red flag guidelines one could put in place as a lender to detect that, and maybe not even allow stated incomes in a lot of cases requiring tax returns that would easily document that the income has been inappropriately falsified.

So, I think to get at the issues that were raised, I think disclosure is probably fine for somebody who really does qualify, and should have a stated-income loan, but a lot of the abuses are substantive problems that would need substantive regulation.

COUNCIL MEMBER SEEBACH: Sheila, I believe, and then Carolyn.

COUNCIL MEMBER CANAVAN: Until recently, I had not been doing much litigation with regard to brokers, and I've gotten a real education lately about that.

But one of the things that I've learned is that, in terms of wholesale lenders, there's this person named an account representative who is the point person for the wholesale lender that works with the broker. That person is responsible, as I understand it, for developing broker relationships, and then maintaining them.

Well, first of all, these people earn upwards of $700,000 a year. Why? High school graduates. Look at the market. Look at what's really happening. Go on line. Do some research when they advertise these jobs. These people are, in addition to their, you know, highly commissioned jobs, they're offered Rolls Royces by some groups. Come on. What is this market that we're talking about?

But, what really concerned me, also, is that for some of the wholesale lenders, the account representative is the one who receives the loan package from the broker, not the underwriter. Isn't that interesting? And why?

In my opinion, that's where the fraud comes. The account representative is instructing the broker how to defraud the secondary market as well, as the borrower, in terms of the income documentation, and other things.

COUNCIL MEMBER SEEBACH: Carolyn.

COUNCIL MEMBER CARTER: I wanted to follow up on what Hattie said. I think the lack of responsible underwriting is a real problem.

At the October meeting, Diane Thompson read from AIMS Prospectuses in which AIMS said it was -- it underwrote only on the teaser rate -- did not underwrite on the fully indexed rate.

Much less, the worst-case scenario rate adjusted up to the maximum. That's, in my mind, just a recipe for disaster, and responsible underwriting should be a feature of any reform that's undertaken.

I also question whether no documentation loans are ever appropriate.

Alternate documentation loans, I think, are fine. And, in fact, I believe the VA has standards. The VA deals with people with irregular income and income discrepancies, unusual income streams all the time, and it has standards for alternate documentation. I don't understand -- I question whether no documentation should ever be appropriate, because even if a person has income from a small business, or income that's irregular, they should have tax returns. That's a form of documentation. They should be able to document their income in one way or another. And allowing no documentation loans, or at least allowing them in any but the very most narrow circumstances is just an invitation to the sort of fraud that you've been hearing about today.

COUNCIL MEMBER SEEBACH: Stella.

COUNCIL MEMBER ADAMS: I just wanted to go back to something that Lori said about how lenders have a responsibility in developing red flag systems. And, again, this is a place where I think the innovations that have been done, the thinking that has been done by the states' attorneys general, should be taken into consideration in developing what are abusive practices, but also not always doing things in a punitive way, but also highlighting what are best practices. What are the kinds of systems that would be preventative in a way that helps.

And I'm going to be sympathetic here for one second. When we did the major fraud list that has gotten me so buggy on this issue, in Vance County, North Carolina, there were 300 families affected by this one bad broker. The U.S. Attorney is putting him in jail. But it was $11 million worth of fraud just to FHA lenders.

Now, the truth of the matter is that there were, out of that $11 million worth of loans, most of the FHA lenders had two or three. And there was only one lender that should have known, because it was so repetitive. But for the other lenders, they had two or three of these loans, not enough to really pick up any pattern of abuse in their own right.

But in the collective, it was devastating to, not only those 300 families, but it undermined the tax base of an entire county.

And so it's really important to, one, have the red flag systems, but they're not going to catch everything. And so it is important to be able to deal with the brokers, deal with the best practices that you can put in place to do it. But that won't always catch the problem. But it will significantly improve the environment.

COUNCIL MEMBER SEEBACH: Mark.

COUNCIL MEMBER METZ: I guess from a lender's perspective, we share the same concern. We very much want to get rid of bad brokers. And as a common course, we do get rid of bad brokers. It's a hard problem to monitor. It costs banks a lot of money. If plaintiff's lawyers sue brokers, they sue the bank. We tend to be the deep pockets. So, we very much want to knock out fraud. It's a hard thing to do, because that's where a lot of the market comes from.

We do have processes where -- and we sort of talked about it this morning. We do it more on the back end. We don't want to stop the flow, but we do monitor things as they come in. We do re-disclose. We do take steps to be responsible to try to stop these abuses.

COUNCIL MEMBER SEEBACH: I agree completely.

The last question I think for this section is the impact of the HOEPA rules on the secondary market. And I certainly know, from our perspective, we see a good deal more due diligence from the secondary market investors.

But let me open it up and see if there's other good, or bad, or other experiences anyone has had with dealing with the second market on this issue?

No? All right. Ed.

COUNCIL MEMBER SIVAK: I don't have experience with it, but in raising the question about the secondary market, to the extent that the fraud and abuse that we've been talking about is widespread in that a high percentage of these loans end up in the secondary market, it could potentially threaten capital markets, especially as there is increasing rates of subprime lending and this type of lending going on.

COUNCIL MEMBER SEEBACH: Mark.

COUNCIL MEMBER METZ: I guess just a follow-up comment.

I think the second market is not perfect for helping to stop this, but it does serve as a check and balance. When we sell our loans, we sell them with recourse. We get monitored pretty closely from our investors. You know, we'll get lists of loans that are suspect, and we will go back and look at those, and if they're serious, we'll follow up with the brokers. And if they're true, we'll cut off the brokers.

COUNCIL MEMBER SEEBACH: Yes, Faith.

COUNCIL MEMBER SCHWARTZ: Just for clarification on the HOEPA loans, there's not really a liquid secondary market.

COUNCIL MEMBER SEEBACH: Agreed.

COUNCIL MEMBER ANDERSON: So, the assignee liability is such that people will only check to make sure you didn't send them one through adverse samples, I think. So, I just wanted to clarify that.

COUNCIL MEMBER SEEBACH: But I do think that, because they are doing those checks, which is probably a lot more than what we saw five years ago, they are -- there is much more scrutiny to make sure that the pricing is what's been reflected.

Carolyn.

COUNCIL MEMBER CARTER: And I'd like to stress that that is because of the assignee liability provision. And if you want any regulations, or any reforms, any protections to be effective, to actually be enforced by the market, you'd have to pass that liability along so that the liability goes with the loan.

If a loan can be washed by transferring it, then it will be transferred, and the market will not prevent those loans from being made.

COUNCIL MEMBER SEEBACH: Any final comments?

Stella.

COUNCIL MEMBER ADAMS: We skipped over the question of what I think is the greatest triumph of the 2000 rules --

COUNCIL MEMBER SEEBACH: Sorry about that.

COUNCIL MEMBER ADAMS: -- and that's the elimination of single premium credit life insurance. That was the greatest thing that happened out of these rules. And you have saved homeowners thousands, and thousands, and thousands of dollars. I believe it even had a little ding on your macroeconomic, because you had more money to spend at Michaels stores.

MS. BRAUNSTEIN: I think we should just end the meeting right now.

COUNCIL MEMBER ADAMS: And bask in the success.

COUNCIL MEMBER SEEBACH: There you are.

Thank you very much.

Lori, back to you.

COUNCIL CHAIR SWANSON: That was a great way to end. Thanks.

Our second subtopic within the overall topic of home-equity lending is shifting gears a bit, and that's the subprime mortgage market, and how consumers shop for credit within the subprime mortgage market. And then, what that means for the prices and the terms that consumers pay for the credit that they receive.

And Stella Adams, Vice Chair of the Community Affairs and Housing Committee, is going to lead the discussion on this topic.

COUNCIL MEMBER ADAMS: Thank you, Lori.

There's been a lot of discussion about how consumers shop for credit, and how does that affect the loans that they receive, and a lot of information about consumer behavior.

The CFA, Consumer Federation of America, just recently released a study of some focus groups that they did, and that might be something that we want to look at further.

And we only have 30 minutes for this, so I'm just going to kind of start things up without too much prelim. And I want to ask Sarah if she'll begin the discussion by talking to us about, how do consumers obtain high-cost mortgages. Do they primarily act in response to lender and broker advertising in the marketing efforts, or are they actively looking for home secured loans?

COUNCIL MEMBER LUDWIG: Okay. So, let's take the question, how do consumers shop for credit, and how does that affect the loan terms that they receive, and take a step back and say, do consumers shop for subprime credit? I work in New York City, and the people that we see are sort of two subsets of consumers. So, how do consumers shop, I can't speak to the model of the consumers out there, but I can speak to the people we see, and they're either homeowners who are in default or risking or facing foreclosure.

Or they are first-time home buyers, people who are relatively low income who are contemplating home ownership.

And in the refinancing pool, like I said, these are mostly people in default or facing foreclosure, and I can tell you, in all the years that I've been doing this work -- and it's been ten years -- nine out of ten borrowers that we deal with who got a subprime refinancing loan, did not go out and shop for it. It came to them. They were solicited for this refinancing loan. And, you know, that I'm sure came up at the hearings, and this is sort of a story well known to people who have been looking at predatory refinancing lending those last years.

But we've also seen a transformation of this problem, or sort of a next phase of this problem with the layer of refinancing abuses that's so concentrated in our city -- I'm in New York -- particularly in low-income communities of color where there's a relatively high degree of home ownership, we see that, through the refinancing scams of the late ‘90s and into this decade, that with the high rates of foreclosures that are so concentrated in these communities, we see companies going out and buying up properties at auction in these communities, and setting up what’s sort of cropped up all over New York City, but I think all over this country, which are these one-stop shops. And they buy these properties relatively on the cheap. I’ll shock some of the people from around the country who don’t have the kind of housing market we have in New York City. They buy little houses in Brooklyn for $300,000 on the cheap -- right -- and do cosmetic repairs to them, and advertise very heavily.

In New York, it’s through our newspapers. It’s all over the subway. You see happy families standing in front of homes that look like they’re in the suburbs, even though this is a New York City marketing technique, here, and they say to people, “Pursue your dream and become homeowners.”

And it’s the refrain that we’ve been hearing in another context. Bad credit? No problem. No credit? No problem. We will show you houses, because we have realtors. We will hook you up with a loan, because we’re mortgage brokers. We’ll appraise the property for you. We’ll inspect the property for you. Home ownership, buying a home is a very complex process, but we’ll guide you through it. We’ll provide an attorney for you at closing.

And this is where a lot of first-time home buyers in New York are ending up through the first-time homebuying process getting their loans. And these one-stop shops that have cropped up largely were doing their loans through FHA for years. But that’s kind of tapered off. What we’re seeing now is that these one-stop shops are mostly originating no documentation loans.

And so, you know, there’s people that we’ve interviewed who were told, you know, who were in foreclosure, who said to us, “Well, I went to this place. It has this nice, beautiful office. Well located, well lit. They looked really legit. They showed me a couple of houses, and they said, you know, your income -- you know, you’re kind of the margin here to afford these homes.” Which, by the way, are for sale a few weeks after they were purchased are now selling for 4, 5, $600,000. They’re saying to people, “Don’t worry about it; we’ll get you a tenant. We’ll hook you up with -- we’ll help you fix up the basement or the top floor. You can rent it out and increase your income. You’ll be able to afford this loan.” Or, you know, “Don’t worry about it, you know, we’ll hook you up.”

So, there's one person that we interviewed in foreclosure who said that he would do anything to keep this home and so he has taken on a third job to make his payments.

There's another person who told us he's a veteran, that he's eligible for a VA loan. He knew he had good credit and that the lender said to him -- actually, that's the thing. He said it was a lender, but I'm pretty sure it was the broker. But it's a one-stop shop, so in a way it's all the same.

He said, no, no, no, no. You don't want a VA loan. We're going to get you a no documentation loan because we don't have time to process the VA loan. Got to hurry. Got to hurry.

So, we're seeing a lot of people getting swept into this very tirelessly and very expensive loans that are really messing people up down the road.

By the way, these homes are not, you know, they're not fixed up, so after people move in they find out that the loan terms in terms of the transaction, they find out that their home needs substantial repairs and that sends them absolutely over the financial brink after that first rainfall or snow storm or whatever it is that shows that them that their roof is leaking, etcetera.

The last thing that we observe in New York about people shopping for credit and, particularly, high cost credit, is that I've been to quite a few first-time homebuyer seminars that banks have made presentations at. And there are three instances over the last year where I've been on a panel with somebody representing a very large bank. There's two banks involved, three episodes where the banker told the group of people in the room no, no don't shop for credit. It will adversely affect your credit score. Don't shop around. Come to us. We have products for everyone.

COUNCIL MEMBER ADAMS: Thank you, Sarah.

Anybody else want to talk about their experience with consumer behavior in terms of shopping for loans?

Forrest and then Hattie.

COUNCIL MEMBER STANLEY: I'm a little bit scared going after that.

Our experience is a little bit different. We do originate subprime loans. But we advertise in the media and most of our -- the vast majority of our origination are inbound calls to us. In other words, we're not going out and soliciting customers. They're coming to us as a result of media advertisement, television, radio, newspapers.

I don't know how many lenders they may have contacted before us and whether they're effectively shopping. But it's not like we're out there cherry picking them either.

COUNCIL MEMBER ADAMS: Hattie.

COUNCIL MEMBER DORSEY: I would say that the low- to moderate-income shopper is not shopping. That they are being sought out by the subprime lender.

I would say that people around this table know to shop for the best loan because we basically are in the industry or close to the industry and know that there are lower rates offered or watch the paper for the rates and know the prime rates. And can negotiate at the table.

Most individuals who are buying their first or even sometimes their second loan or their second home rather are just happy to get the loan. They want a yes. And that becomes the carrot for that individual. And so I think that it is targeting a certain population and that the banks who own the subprime lenders know exactly who the client is going to be. And, again, I go back that they are dependent on the broker industry to bring those clients to them because they're out in the community. They know the neighborhoods. They know the community and where this population of individuals are who will probably not be shopping and believe the lines that hit your credit rating too many times and your scores are going to go down.

COUNCIL MEMBER ADAMS: Thank you.

Marva.

COUNCIL MEMBER WILLIAMS: I agree wholeheartedly with Hattie. And just as an illustration, I'd like to discuss some of the results of our research in Chicago. There is real targeting I think of African-American and other minority consumers.

In Chicago, an African-American consumer who has a low income is three times as likely to receive a higher price loan than a lower-income white consumer. And when it comes to higher income, they're five times as likely to receive a higher-income loan or higher-interest loan than a higher-income white consumer.

And what's most dramatic about these figures is that a higher-income African American is still twice as likely to receive a higher interest loan than a lower-income white consumer.

And so we think that there is targeting going on. But I think that this is a very complex issue and I'm very grateful to the Fed for actually addressing this issue of shopping behavior. Because I think it's very important.

I think that it is a matter of targeting and I'm very concerned about the lack of marketing and outreach programs at mainstream banks. I think that refer up programs are also important so that if someone who has prime credit, they should receive a prime loan, regardless of the channel that they enter.

But I also think that this points to the real importance of the service test and CRA, which I believe is in some ways one of the weakest tests, because it lacks quantitative analysis.

The service test looks at things like branches and I think that branches are a really important component when it comes to lending.

We've done studies that have made connections between greater levels of small business lending and the location of branches in low-and moderate-income communities and minority communities. And there's also a very real link between the location of branches in residential lending as well. Many banks use their branch networks to deploy their loan officer staff. It's the managers and the tellers who get to know the communities, to learn more about consumer behavior in those communities as well.

But I think most importantly, the services test I think demonstrates the importance of financial services for all consumers. People need a way to pay their bills, to cash their checks and also importantly a place to save.

But, moreover, it's part of that relationship that a consumer develops with their bank that can help to negate some of the messages that they received as a result of the targeting. The very real and very aggressive targeting of mortgage brokers and subprime lenders. And so I think that we should look at CRA and the service test as in a synergistic way and not to consider them in an isolated way and to underline the importance of the service test and its impact on marketing and outreach and lending to low-income and minority consumers.

COUNCIL MEMBER ADAMS: I think that's a good segue into our next question which are around; could a significant number of borrowers with higher cost subprime loans have qualified for a prime loan. And why do these borrowers nevertheless end up in these high-cost loans?

And I'd like, Alan, if you could, to talk a little bit about, do borrowers generally have access to their credit history and qualifications? Do they know what they're doing when they're out there shopping?

COUNCIL MEMBER WHITE: Well, there are several questions embedded in your question.

As far as consumers' self-awareness of their credit that tends to be certainly flawed from my own anecdotal experience asking clients what they think their credit is and then looking at what it really is.

Certainly, the availability of free credit reports just in the last year is a tremendous advantage. And I'm now able to review that with every client. And I suspect that more and more consumers, even going down fairly low in the socio-economic ladder are going to get a greater awareness of both their credit history and what their credit score is.

That unfortunately is only a small piece of the information problem when you're talking about subprime mortgage purchasing or shopping or whatever you want to call it. I think even with all the sort of passive shopping, you know, the loans coming to the consumers instead of the consumers going to the loan, information can still have some value.

If people have sort of a colloquial knowledge of what rates are, that's very helpful even when they're only dealing with one broker. And I have many, many clients who have no idea of what the prevailing mortgage rate is. In fact, I was very disturbed when I did a training of mortgage counselors -- I'm sorry, home ownership counselors, who were supposed to be advising first-time home buyers. And I started by just asking them. I was going to talk about predatory lending and subprime lending. And I asked them what the prevailing rates were for prime mortgages and subprime mortgages and a surprisingly large number of these counselors really had no clue.

But to some extent people know what the prime mortgage rate is because of advertising. And we don't have rules that require price advertising. So, what we have is if you open up the real estate section, you can see what the rates are for conventional, conforming, and prime mortgages. The retail rates for subprime mortgages generally are not advertised. There are exceptions and I think I talked to Bruce who said he advertises his subprime rates and that's fabulous. But generally speaking they're not advertised. And there's no legal requirement that they be advertised, so it's rather difficult to see how a consumer could shop.

And once you try and obtain price information from subprime lenders, if you ask, you invariably get the response, well, it depends. You know, basically you'll have to go through the entire application process and incur a lot of shopping and transaction costs before you get price information.

So, that's kind of a structural problem to consumers having knowledge about prices, even if they know about their own credit.

And, you know, I've also found at least anecdotally that when you look at multiple credit scores that people have, there tends to be a certain variance in that. And I'm a little puzzled about that.

I think that there are some data quality issues with credit information that affect people's credit scores. But that's a whole separate problem area.

And, you know, finally I just want to say there's also the complexity of the products. Aside from what the prices are, the complexity of a subprime mortgage, given all the permutations with no doc and prepayment penalties and all the other options you can find on those matrices, means that ultimately you're going to have a big segment of the American population. And certainly half or more who are just never really going to be able to grasp all those tradeoffs and, you know, so information I think will help us get some of the way, but it's not going to get us all the way having a more efficient and effectively and fairly priced market.

COUNCIL MEMBER ADAMS: Thank you. Are there any others? Yes, Mark.

COUNCIL MEMBER METZ: No. I was just -- I was going to agree with what Alan is saying. I know this is one of our topics later. But the financial literacy is a way. I know very many responsible lenders do support literacy programs. My bank has two specific programs we try real hard on. It's a start. It's not the solution or it's not the full answer, but it's a start.

COUNCIL MEMBER ADAMS: We're going to go on and talk about do lenders that primarily offer high-cost loans, target their marketing areas -- marketing efforts towards certain populations or neighborhoods. Or is there marketing merely more effective with some borrowers who might not be aware of other options?

Ed.

COUNCIL MEMBER SIVAK: I wanted to echo some of the comments that were made and also make some additional comments.

And this actually is consistent with some of the research that the Fed staff presented yesterday. That as you move from most prime borrowers who have a sense of their credit score and rate and terms, into the subprime market, you move from shopping price basically -- terms, to trying to find a yes. And that is what was communicated yesterday.

And in some instances, realtors are involved with this. A borrower is working with the realtor. There is a desire to get into a home. A realtor has a relationship with the broker and the broker can provide that yes.

Another thing that I wanted to also reiterate was Marva’s comment about the Community Reinvestment Act. As we see branch reduction in low-income communities, windshield surveys in any community shows what takes their place. Finance companies, brokers. That is what people who live there see as their primary entry point into the financial marketplace.

And then the final piece in terms of just looking at the roles that brokers play in people’s access to prime credit when they may be qualified, it’s easy to get a broker’s license. At least it is in Mississippi. It’s an incredibly easy thing to do.

And because of that, many brokers lack the sophistication to offer the products that people would qualify for.

If someone walks in the office of a finance company or a broker and they may qualify for an FHA loan and the broker lacks the sophistication to complete that transaction, that person is going to end up with a product that is not consistent -- the most beneficial product for that person.

So, those are the points. I don’t know if I answered the question or not.

COUNCIL MEMBER ADAMS: Yes. You did.

Alan.

COUNCIL MEMBER WHITE: I just wanted to add something to follow up on Marva’s comment which is an excellent one.

In my experience with clients who have subprime mortgages, many of them have banking relationships with banks. You know, Wachovia is a big one in Philadelphia.

You know, I ask people when we do our budget, where do you have your checking account. At Wachovia. And why did you get a mortgage from a broker? Did it ever occur to you to go ask your local bank branch for a mortgage? And very quickly I get the sense that people have either had bad experiences or they have some reason to feel that the climate in that branch is not really conducive to them getting home-equity financing or a mortgage refinancing or a purchase mortgage. And I'm not entirely sure what the reasons are. But it does strike me that it would be a useful service test to ask the bank. You know, you can with the data that are available now very easily find everybody who is your customer, has a FICO score of let's say 660 to pick some cut-off or higher, and currently has a mortgage with one of the following 20, you know subprime mortgage lenders. And why don't we aggressively, you know, push market those people. In theory, that's what the market ought to do. Right? People who are overpriced, the market should find them and bring their price down. And it doesn't happen. And I'm not sure why that is.

You can look at frequency distributions of FICO scores and subprime loan pools that are issued and see significant percentages. Thirty, forty, sometimes fifty percent of the loans are being made to people with what I consider to be prime FICO scores. And that's a mystery to me why those people are not being aggressively marketed by fine lenders. And I commend -- well, Forrest isn't here anymore but he was talking about the way he markets subprime. I'm just curious what Key Bank's market share in the subprime market in Cleveland is. Because I think they tend to get drowned out by the push marketers.

COUNCIL MEMBER ADAMS: Mary Jane.

COUNCIL MEMBER SEEBACH: Well, I was just going to comment that it's very interesting that you note that they have bank accounts and mainstream lenders don't have the mortgage. I mean, we've certainly heard through focus groups that we kind of tried to prove this issue and find out why they're not going to a big lender. And often it is as Ed and I think Hattie both noted they're shopping for the yes when they actually are looking for credit.

And often that means they go to a relationship. So, someone in their church knows somebody. Somebody in their community knows somebody. It's usually not a mainstream lender. But it's someone who has hooked them up and they don't -- you know, there is a certain intimidation factor, I think, that's connected with going with a big lender for whatever reason. And, you know, it's something we need to overcome. It's clearly something we're trying to focus on and figure out.

We do, of course, market to lower FICO scores because we have a non-prime unit. But it's an interesting question that we're all trying to tackle.

COUNCIL MEMBER ADAMS: Faith.

COUNCIL MEMBER SCHWARTZ: Just one thought about the higher FICOs.

Looking at what kinds of loans and borrowers are getting those FICOs and if they're going to a non-prime shop versus a mainstream bank, sometimes it's very much product-driven, LTV driven, second home investor driven where a lot of the mainstream prime lenders may not have very many alternative products and programs and that's what I've seen when I've looked at who are these people in these loans and what are they getting out of a higher FICO loan.

COUNCIL MEMBER DIEDRICK: I just want to kind of respond to also what Mary Jane was talking about. And it's really the psychology of the consumer who is probably looking for subprime because they've gotten some financial problems. And there is this, you know, head in the sand thing about I've got some financial problems. I probably shouldn't go to the mainstream bank because they probably don't want to hear that I have some financial problems. And they probably don't have the right products. And that's probably why they're reaching out to some other lenders.

And we, you know, in talking to a lot of community organizations over the years who would be dealing with somebody who is a Chase customer, who is in default in their mortgage, afraid to call the servicing department, they're really -- they're scared, you know. They're not making the mortgage payments. They're scared.

We started a program, a department about two years ago called Home Ownership Preservation Office. And it's an intermediary office between our mortgage servicing department and people who work in community legal offices or community organizations that are dealing with consumers who are having serious mortgage problems to make that kind of -- to be the conduit between Alan White and the mortgage servicing area to get the person comfortable that they can talk to the bank using the intermediary to get them there. And it's really, I think, helped a lot in moving. Because what is the most important thing here is early intervention. Getting to people as quickly as possible with the options for redoing their mortgages as fast as possible. Because the longer they're out there in denial, not answering the phone, not, you know, not talking to people other than maybe somebody in their church or whatever who could get them to the wrong person, you know, to get that refinance of the loan, the better.

So, that was the -- because we have to also think about the psychology of the consumer every step of the way, particularly when they're in distress.

COUNCIL MEMBER ADAMS: And I'm going to let Dorothy be the last speaker on this.

COUNCIL MEMBER BRIDGES: We don't do mortgages in our shop. We're commercial lending, so I don't have any skin in the game. But when I slip on the television channel and I see a Diatech commercial where a customer walks in and sits before this lender, i.e, banker and the lender throws a stack of paper this high on the desk and says your loan has been approved. We just have to go through this paperwork.

And if I take that to heart, certainly a bank would not be the place that I would go for mortgage lending.

I think the customer mortgage industry is such a volume business. Every institution looks for efficiency with what they try to do and how they try to deliver a service to the end consumer. And we have to be very candid and honest with ourselves. It's those who stand to benefit and gain the most, do a much better job at focusing and targeting and advertising in these communities.

And at the end of the day, all we have to rely on is our credibility and our reputation in the community and doing a lot of financial education about the fact that when we do things, we do them the right way, i.e., all of the paperwork that's thrown on the desk.

But if there are people out there saying, we don't have to go through all of that paperwork and we can get you your answer in minutes.

COUNCIL MEMBER ADAMS: Thank you. And we've actually hit the 30-minute mark.

But there was one other question that both Faith and Sheila wanted to address related to one of the questions that was asked. And so I'm going to ask Faith and Sheila if they will speak to this. And that is, do lenders and purchasers of mortgages adequately monitor brokers to protect against practices that could lead to foreclosure and lender losses? And, if not, why?

I think we talked about that some in the earlier conversations. So, if you all could -- first Faith and then Sheila and then we will draw it to a close.

COUNCIL MEMBER SCHWARTZ: Well, it's interesting. We spoke to this a little this morning at breakfast. You know, how do you do a great job monitoring the front end of your business if you're not at the point of sale? And I think the question really could be. Do we monitor our retail loan officers and our brokers as well as -- not to be unfair to brokers. It's certainly not always a broker.

I certainly know in our company, we've really done much better in the last two years than we did in the two years before that to do the front-end background checks, criminal checks, you know, all the major checks. And also participate industry-wide legal repositories for bad brokers.

I don't think there's enough and I think it was earlier mentioned that tracking and accountability for the broker community or bad actors in your own company. If you let them go, what else can you do?

I know we work with all the enforcement agencies, the FBI and others, to do that and it's costly and time consuming one by one. And there are thousands out there. So, the industry hasn't done a good enough job on that side of the business. And that's my feedback. I think it's getting better. And certainly needs to get better because it's not in anyone's best interest, the borrowers or lenders, to have high foreclosures rippled with fraud in the industry.

So, I hope that was helpful.

COUNCIL MEMBER ADAMS: Sheila, Mark and then --

COUNCIL MEMBER CANAVAN: Yes. Well, my answer to the question based on my experience, my clients' experiences, is no. There's not enough monitoring of brokers and why would there be. This is a volume-driven business. And it is a business governed by compensations directors that encourage fraud. And people look the other way because the economics of the marketplace, the economics of the deals dictate that they look away.

COUNCIL MEMBER METZ: I guess maybe to repeat what I had said before.

We do try real hard to monitor them because it's in our financial interest to do so. We get sued. As the brokers get sued, the banks get sued. We get loans back to us on the secondary market. And it's our reputation. So, we do try real hard. It's not perfect. But we do have back-end monitoring systems to knock out the bad brokers.

COUNCIL MEMBER ADAMS: Anne.

COUNCIL MEMBER DIEDRICK: I just wanted to follow up on what Faith was saying about retail.

We talked a lot about brokers, but lenders also need to have the right stuff in place to monitor their own retail loan officers. And so not only, you know, are we monitoring our brokers every month, every single broker gets monitored. We're also and spoken to and dismissed if they're not sending us what we expect.

For instance, sending prime loans into our subprime channel when they know better. But we monitor every loan officer every month for the pricing on their loans. And we have a whole escalation program to the point where, you know, if they can't get their fee, they're going to walk out the door.

So, you know, it's not just the brokers. It's your own employee, your own commissioned employees that you have to really careful watching.

COUNCIL MEMBER ADAMS: Thank you.

Sheila.

COUNCIL MEMBER CANAVAN: I just wanted to add something to what -- comment on what Mark said.

Although there are negative consequences for lenders, you know, such as you described, I think that if you weigh the economics, you know, they're just viewed as a cost of doing business.

COUNCIL MEMBER METZ: I think some lenders may view that. I think most reputable lenders do not. And try real hard to really do weed out the bad brokers. There's a lot of brokers out there. It's hard to get them all. The bad ones. But it's just not in our interest to let them go.

COUNCIL MEMBER ADAMS: Alan.

COUNCIL MEMBER WHITE: I think both of the stories that we're hearing are true. I think that there are a lot of lenders who do care and, you know, I also agree with Sheila that economically you can price the risk of dealing with bad brokers. And our experience has been, we were chatting last night about some of the cases Sheila is involved in Mississippi with bad brokers. And I had to laugh because the same lenders are the ones involved with the brokers that I'm going after in Philadelphia.

It doesn't take very many lenders whose scruples are a little less, shall we say. Frequently, it's one or two or three that the worst brokers in my community are going to as, you know, the go-to lenders are the ones who see no evil, hear no evil. And those lenders, you know, some of them have not stuck around. Some of them have filed for bankruptcy or have just been shut down. But more seem to crop up. And they're always in the top ten originators. Invariably, there's one or two in the top ten.

And, you know, some of the worst cases we saw in the last couple of years came out of Ameriquest. They made a settlement and now we don't see quite nearly as many problems with abuses and those were retail loan officers, not brokers.

But I think the problem is that the dynamics of the market do allow a lending model in which you allow brokers to bring you just about anything and you have fairly loose underwriting standards and you still make plenty of money by pricing the risk. I think there's other business strategies which are obviously more commendable, which involve trying to minimize those losses.

COUNCIL MEMBER ADAMS: Thank you.

With that comment, I'm going to close this out.

Let's see I have to be quiet. One of the things I think that came out of the conversation that I do want to highlight is that when you see your customers, bank customers, you market everything else to them across the market. Everything else to them.

When you see your customers who are prime borrowers and good customers in your banks and bad loans, market that loan to them. Approach them and say why are you paying this mortgage company? Didn't you know you could get a mortgage from us? Why didn't you think about us as your mortgage alternative?

And with that, I'm going to turn it back over to Lori.

COUNCIL CHAIR SWANSON: Okay. Thank you, Stella.

We're now at the point in the agenda where we take a break, so if we could take about a 12, 13 minute break and come back at 11:00 and then we'll pick up with non-traditional mortgage products.

(Whereupon, off the record from 10:46 a.m. to 11:04 a.m.)

COUNCIL CHAIR SWANSON: Okay. We're going to go ahead and get started then with the next portion of the agenda which is the third subtopic of the Home-equity lending markets relates to Nontraditional mortgage products and discussing the market and how it work.

And with that, I'm going to turn it over to Faith Schwartz to lead our discussion.

COUNCIL MEMBER SCHWARTZ: Okay. Thank you, Lori.

So, today we're going to talk a little bit about the nontraditional mortgage products that I think we touched upon some of that in our earlier discussion. But maybe we can just follow up in this discussion with more detail.

I think I'll frame the issue a little bit based on the proposed guidance that was issued. Over the last few years we've seen a significant increase in interest-only ARMs and option ARMs as an example of nontraditional lending products that have really, some would say, exploded. And so at the end of 2005, the Federal Reserve, OCC, FDIC, the OTS and the NCUA agencies jointly issued proposed guidance to address safety-and-soundness and compliance issues with regard to nontraditional products.

They put out their proposed guidance and they did receive I think upwards to 90 letters or so from a pretty diverse constituency, the housing trade, the realtor trades, the consumer advocacy world, lenders, non-bank lenders, community groups. So, they had a really rich feedback and not surprisingly a pretty diverse and disparate amount of feedback on what should be done.

Without getting too into it, I think certainly some felt that there should be even tighter guidance but it was a good start, whereas, banks and industry may have felt that it was too prescriptive and maybe left up to individual institutions, some of the guidance could be left at the institutions and their regulators.

One common theme was that the non-regulated entities that don't fall under any institution may not be impacted by the guidance. And that will be an interesting issue for us to explore.

One thing that came up yesterday at our meetings was that, what else is going on in the nontraditional market so it could be risk-layering documentation, the stated income which was discussed earlier, disclosures, marketing.

And so giving you the background here, I think we'd like to start with a question. What nontraditional mortgage products are currently available on the market other than option ARMs and interest only and we can still touch upon those two as well?

Mary Jane.

COUNCIL MEMBER SEEBACH: Certainly. I know that it's not within what's been perceived so far as the nontraditional, but I'm going to make my little plug for making sure that the Board does address reverse mortgage disclosures.

I think that clearly I tried this in March, but I'll try it again. There's clearly going to be a huge increase in the presence of the reverse mortgage product in the market as obviously as we all get just a wee bit older. But, in addition, I think there are a number of other issues.

I was talking to one of the mayors and he was talking about the fact they've got a property insurance cap which is really going to hold -- and I think this is actually a factor I think that has led to date to a lot of senior citizens getting refinancing and probably getting into trouble with contractors and that sort of thing, that the reality though is what that property insurance cap means is that these people are not going to be able to sell their homes because the insurance payment on that new home as they get older with a more limited income is going to severely strap them.

So, a reverse mortgage product is ideal for this population and there are a number of areas around the country where that's true. So, a lot of market factors are going to lead really to the boom of this product.

I think the issue is setting standards early now to insure that the right amount of information is given to borrowers to help understand the complexity of this product. It's an expensive up-front product which is not to say that it isn't a good product. I think that expense has been built around the insurance aspect of it and also the counseling that is required with it.

But I think what worries me now, all of us feel very positive about how the product has been used to date as it continues to explode and is offered by more and more private parties without guidelines now on the type of information that should be provided and when. There's always the opportunity for abuse there.

GOVERNOR BIES: Can you just sort of clarify, when you say insurance.

COUNCIL MEMBER SEEBACH: Property insurance.

GOVERNOR BIES: Property insurance and describe why --

COUNCIL MEMBER SEEBACH: In California we had the Prop 13 infamous and so until I sell my property, my property insurance is not going to go up. So, I've lived in my home for 30 years and now I want to move to a much smaller home now that all the little birds have left the nest. Even the amount obviously to buy a smaller house is going to be larger, but more importantly, the property insurance on that will be on that much higher property value amount that I had on my original much larger property.

And so what this was leading to was, the mayor was indicating he had an aging population who could not afford to sell their homes because they couldn't afford to have the monthly property insurance escrowed or not escrowed on these new properties because they now had a much more limited fixed income, which was leading to these properties obviously, there was no funds to keep the properties up. So, that was having a negative effect on the neighborhoods and also was opening them up to refinancing abuse and other things. So, there was sort of a strain there.

COUNCIL MEMBER SCHWARTZ: Mary Jane or others, on the reverse mortgages, we haven't heard too much negative above them it sounds like from the responses of the former hearings. And so it doesn't sound like they've grown tremendously in the market and different practices have occurred.

What do you think we can do from the Feds perspective to look forward on this product from disclosure, you know, consumer understanding of the product?

COUNCIL MEMBER SEEBACH: Well, I think that a number of the advocates have identified that counseling has been beneficial. And I think we need to identify what aspects of that have been beneficial and it would be great if the Board either gave guidance in this area or, in fact, if there were amendments to the regulation that could actually address what information should be required to be disclosed, especially going forward. And I obviously think that counseling is always going to be a best practice.

The issue and I was fascinated to hear Alan say that he had to explain to homeownership counselors what the difference between a prime and non-prime rate. And we're actually going to trust these people then to go on and give complicated annuity training to borrowers. It's a frightening thing. There aren't going to be enough counselors to really give the type of counseling that's going to be needed if this product takes off as I think it will.

COUNCIL MEMBER SCHWARTZ: Stella.

COUNCIL MEMBER ADAMS: And here I agree with Mary Jane tremendously. And we have an opportunity to fix on the front end what we're facing on the back end with option ARMs and the interest only ARMs.

The product is successful and fine as it currently is used in the marketplace. And it is a very -- it is a very monitored, maintained marketplace with counselors that have to have certification from HUD. You can't just be any old housing counselor to do a reverse mortgage. While I'm a certified predatory lending counselor and a forbearance counselor, I can't do reverse mortgage counseling without the training, the separate training on that from HUD.

So, as it is currently done, the product is fine for the niche of people for whom it's used just as pay option ARMs for 40 to 50 years have been a fine product when used as designed. But as it expands out into the marketplace where you're going to have scrupulous and unscrupulous people, knowledgeable and unknowledgeable people, investors who are willing to take on any kind of risk as long as it's covered to some extent, you're going to see the product morph into the horror that I believe some of the other products, the pay-option products has morphed into.

And so this is a real opportunity on the front end before it becomes a problem to kind of identify what has made this product so successful. And codify that as a standard for the product.

I think it is really, really important.

COUNCIL MEMBER SCHWARTZ: You mentioned the pay option ARMs which has the feature of negative amortization and monthly adjustments. And interest only has been around for a long time and I think that's right.

Why has that changed? How are the customers being marketed to and what's different today?

COUNCIL MEMBER ADAMS: Well, what I found was that originally these products were meant for specifically high wealth people who had bonuses. It was like meant to serve about five percent of the market.

Now of the total mortgage market, now it's as much as 25 percent of the total mortgage market. And in some cities like the one we're in, it's about 60 percent of the market are in these nontraditional mortgage, interest-only or the pay option products.

These products were really meant for people who had uneven income and so this gave them an opportunity to pay interest only until they got that big bonus check or commission check and then they could pay it down. And these were also meant for people who were disciplined with their money.

And that's the key factor of an interest only and specifically a pay option is to be highly disciplined with your finances. So, that means to me that these are prime rate products and what I am seeing in the marketplace are advertisements by broker, by wholesale lenders to brokers saying we will underwrite a 500 FICO score, pay option ARM with no documentation.

There is no way on the planet that that's a good -- that that borrower is going to be able to manage that loan.

I still don't really understand how the lender is going to make any money off of it. But I know the homeowner is going to lose their home. And I know that's an absolutely ridiculous product to offer. A 500 subprime no doc loan. It is an unconscionable product. And yet that advertisement comes through my office every day on my e-mail. Every day.

COUNCIL MEMBER SCHWARTZ: Marva.

COUNCIL MEMBER WILLIAMS: I agree with Stella that the marketing on these products has changed a great deal over the last several years and that they're being marketed more to lower-income consumers.

But I think one of the other issues and concerns is that these products work best in markets where property rates are appreciating rapidly. And homeowners are then able in some sense to gain some equity in their homes, even if they're making interest-only payments, because of rapidly appreciating markets. And I think that that's a decreasing possibility over the next several years and that homeowners won't be gaining the same kinds of interest or equity in their homes.

I also wanted to mention a new type of nontraditional mortgage. The fixed-rate, interest-only mortgage which allows borrowers to pay interest-only payments for as long as 10 to 15 years which is quite a long time. And the market for these loans has increased tremendously from a little over $8 billion in 2004 to almost $40 billion last year.

And these mortgages, I think are very problematic for borrowers because, first of all, it doesn't allow them to build the equity in their homes, but also because of the potential payment shock where the payments will increase dramatically in that period of time.

In addition to that, the savings for these mortgages are not really as great as some of the lenders will market. And, for instance, for a loan of $300,000, a borrower will actually pay more for this interest-only loan over this period of time and compared to a fixed-rate loan at a lower interest rate, the savings are only about $200 a month.

And then at the end of that interest-only payment, the payments will increase by as much as 35 percent. And so I'm very concerned about the payment shock as well as the lack of equity that people are building in their homes.

COUNCIL MEMBER SCHWARTZ: So, just to clarify.

On the interest only, I think initially we had, you know, maybe two-to-five years interest-only product. So, as newer products evolve, we should be looking at a longer interest-only period. That's one of the new morphed products to think about.

Yes, Mark.

COUNCIL MEMBER METZ: I guess just to follow up on what Stella said. I agree with just about everything she said. I just want to clarify one or two things or give another perspective.

I particularly agree with your point that these -- and I really want to speak to the option ARM. That that product is morphed into something very different than I think it originally started. But I do want to point out that certain very reputable lenders have been offering option ARMs for a long time. They've actually not been offering -- they've been offering to a broad spectrum of people, make prime borrowers not really just part of the banking folks. And disclosed right and underwritten properly, these products can work.

COUNCIL MEMBER ADAMS: I agree.

COUNCIL MEMBER SCHWARTZ: Disclosure is a great segue into what's happening on the front end of these fairly complex products. I'm not as familiar with option ARMs. I am on the interest only and Faith had some thoughts on that.

COUNCIL MEMBER ANDERSON: I have a good friend who has an advanced professional degree and he had an acquaintance who was a mortgage broker who said well, why don't you think about taking out an option-ARM loan to buy your vacation home. You'd only have to pay 1 percent for the whole year.

And so, you know, he got the loan. He knew he had a variable rate loan. And it wasn't until -- he said the disclosures were complicated. There was a two-page brochure explaining, but it didn't really explain very much. And it wasn't until after he received his first periodic statement that he realized when he was paying the 1 percent that it was a negative amortization payment, because he saw two interest payments a 1 percent and a 3 percent.

And so that was -- he was able luckily he was able to pay more. He was able to pay at least the interest-only payment. But then he noticed on his statements every month that the interest rate kept going up by an eighth of a percent. He still only had to pay the 1 percent. Because that was the real rate was the rate that he was receiving every month on the statement. And when he called the lender, at first, you know, he wasn't getting the right people who even understood their product. And it was only after he was able to get a hold of the right person, that they explained, well, that's a negative amortization payment and that if the real rate, you're only required to pay the 1 percent interest rate, but your interest rate, the real rate will increase every month and adjust next year to the 3 percent. That's all you have to pay, but your monthly rate can still adjust every month. And he wasn't aware -- he didn't realize that his rate would adjust every month. He thought it would just adjust yearly.

And so luckily for him, he had the means to pay more. He was able to refinance to a 30-year fixed, but I hate to say it, but he was an attorney. He didn't understand the disclosures.

So, when I hear Stella or people here say that, you know, they're offering these products to subprime, I don't know how they can understand it if, you know, an educated person who is getting a disclosure. And thank goodness he's looking at his statements to realize what he really had.

And so I think it would really help if the disclosures were simplified so that it's just easy to understand and maybe even do some testing like Alan suggests so that consumers know what they're getting into.

COUNCIL MEMBER SCHWARTZ: Yes. Alan.

COUNCIL MEMBER WHITE: Yes. I think to tie this maybe a little bit with the discussion about reverse mortgages. There's a certain level of complexity of financial products that are so complex that disclosure in the sense of providing written information to the consumer without any further assistance is futile.

I think reverse mortgages are an example of that. I think the reason that market has worked is the combination of the fact that FHA has very strict counseling requirements and the fact that the market somehow hasn't been able to create a large presence of non-FHA. You know, the FHA insurance has really been critical to making that product happen.

That's going to change clearly.

I think it would be a good idea to look at certain mortgage products including reverse mortgages and option ARMs and think about those in terms of either mandatory counseling or some kind of duty for, you know, the same kind of duty you impose on stock brokers and insurance sales people, you know, whatever that may be. A fiduciary duty or suitability standard or some kind of standard that causes, you know, the professional to have some responsibility for the product they're selling to you or some other solution. I mean, there are any number of ways of looking at this, but giving people paper disclosures on super complex products, is a recipe for a lot of inappropriate sales, I think.

COUNCIL MEMBER SCHWARTZ: One of the questions which seems to be lingering over the disclosures is there additional information that should be provided under Regulation Z which implements TILA but is not currently required? Should any required information be eliminated or modified because it's confusing to consumers, unduly burdensome to creditors and not relevant to nontraditional mortgages? That's an earful.

Carolyn.

COUNCIL MEMBER CARTER: Well, Alan mentioned the pre-payment penalty earlier. I don't think I need to restate what he said. Also then the worst-case scenario is very poorly disclosed under the current regime. That's something clearly within the Fed's authority and it ought to be fixed.

COUNCIL MEMBER SCHWARTZ: With a prepayment penalty, worst-case scenario?

COUNCIL MEMBER CARTER: I mean, the worst-case scenario. I'm talking about two different things.

One is the prepayment penalty scenario and the second is the worst case scenario for the payment which is -- it's clear. I there's a disclosure of that with a hypothetical $10,000 loan, not your loan that is made early in the process that very few consumers get. And that is since it doesn't relate to one's own loan terms, it is not a very useful disclosure.

COUNCIL MEMBER SCHWARTZ: Faith. Josh.

COUNCIL MEMBER PEIREZ: Well, I come from Dorothy's camp on this and our business is not involved in this. And I do know very little.

But from Faith's comments earlier about her friend and I think a lot of things we discussed yesterday, I don't think it's so much the written disclosures. I'll agree with Alan. I'm not sure how many people actually read all the written disclosures in connection with a mortgage or other home-equity product. Nor do I think it would be particularly useful if they really focused on it for hours on end. Especially at a closing when you're, you know, you're moving. You've got -- perhaps you've moved out of something.

But I do think that the mortgage broker piece of this, I'm finding very troubling from all the discussion. And I know that various members of Fed staff have indicated to us that they have little to no authority over mortgage brokers. And that's something I'd like to explore further in terms of understanding exactly what authority the Fed does have over the mortgage brokers directly and what duties can be placed on the mortgage brokers directly.

And I don't know if the point about fiduciary duty was specific to mortgage brokers but if that's the point of interaction for origination of a huge percentage of these loans, then it seems that frankly almost exclusively the information a consumer is internalizing is from that conversation. And they would have to realize that something in the disclosure is saying something different than what that broker has indicated. And, yes, based on default rates and other things on the back end, I think the industry controls against that. At least the good actors do. But without that direct duty, which makes it easy to go after mortgage brokers directly, I think it seems like a big gap. And I'm just wondering, you know, if anyone has other views on what the Fed authority is. I know Carolyn does. But if she could voice that or others could, that's something of interest to me from this discussion.

COUNCIL MEMBER SCHWARTZ: Do you want to respond to that or hold for a minute?

COUNCIL MEMBER SEEBACH: I'll hold for a minute.

COUNCIL MEMBER SCHWARTZ: Okay. Alan.

COUNCIL MEMBER WHITE: I think the guidance is a very interesting starting point for that discussion. Obviously, a conundrum in regulating abusive practices in the mortgage industry is always this multiplicity of regulatory authority. And there is a big segment of the market that obviously consisted of non-depository institutions that are regulated at the state level or theoretically I suppose by the FTC.

I think one of the things that I really liked about the guidance was the notion not only that it's an interagency guideline for all the Federal agencies, but that it could come, and

I think some of the commentators said this and maybe it's controversial, but it could come to be sort of a standard of what are unfair and deceptive practices which are prohibited both by the Federal Trade Commission Act under Section 5 and by most state consumer protection laws that apply to all -- well, in many states they apply to all financial institutions. Certainly, the Federal statute does, although it's only enforced by the FTC.

I think another approach that could be useful is working with the state regulators. And know the Fed is doing this to some extent already. But if the federal financial -- the state financial institution's regulators were to adopt similar kinds of guidance and standards, not only on the issue of nontraditional products, but on some of these other issues we've talking about to regulate the conduct of the mortgage brokers and bankers at the retail level with the same kind of standards that we want to impose at the Federal level, that could be a step towards dealing with this problem.

And, you know, I certainly agree with Carolyn that the Fed has direct regulatory authority for abusive practices in the mortgage market. But another approach is to get the states to use their oversight authority and to try and develop some uniformity of standards to deal with both abusive practices and with the recommended good practices to help consumers with these complex financial products.

GOVERNOR BIES: I'd like to clarify something.

The interagency document that all you guys are referring to is guidance to our examiners about what the exam procedures are. It is not a rulemaking in any form. So, this is what, in the light of varieties of products and varieties of actual work that examiners are doing, we thought it was important that we get more specific guidance to our examiners as to what to look for when they go and do an exam.

And so these are questions that they should be going through. It may mean that they change the scope of their exam. What is unusual -- normally when we give instruction to our examiners, we never go out for comment because that's how we're telling our folks how to do their job. And we will train to this. And we are changing our training programs interagency to reflect this.

But that plus the commercial real estate guidance that went out the same for -- we wanted to get people's attention. It went out for comment. But it is only guidance. It's not any rule in any sense. To do that, we would have to amend Reg Z or Truth in Lending kind of things if we’re going to do something or we got the HOEPA things. There are a lot of ways we can approach it.

But at the end of day, it was mentioned. The Fed has got some powers as the fed in terms of writing some rules. But it is up to the states who license the mortgage brokers.

We can look at lending officers who are part of the depository by one of the federal regulatory agencies. Because one of us will touch any insured depository. But we can’t do anything with lenders who are not part of an insured depository to see if they’re following guidance or rules or whatever may be out there.

And that’s up to the states and the states have a wide variety of practice from actually licensing and testing or just licensing or actually going and following up on compliance. They all -- there are so many practices out there. But that’s up to the states to deal with and while they’re working, we don’t on the federal level have any direct way to make that happen.

COUNCIL MEMBER SCHWARTZ: Thank you, Governor Bies.

Actually, I need to get back to Mary Jane. She’s been patient.

COUNCIL MEMBER SEEBACH: Thank you. And that was kind of a great opening because I first was going just talk about the disclosure issue, which I do understand there is complexity to this and that a lot of people feel that disclosure in and of itself is not enough.

The reality is, we do have to improve disclosures that are out there and we have to set a uniform standard to insure that all creditors offering these types of products are offering the same information. And I do think improved disclosure of the negative amortization feature, how much the loan amount might increase, how quickly the interest rate could increase. And I also do think. I think there’s a -- certainly within our shop the pay option product is for borrowers with on average a much higher FICO score, a much lower LTV and other factors. This is a financial management tool.

One of the things that concerned me about the nontraditional guidance is it is tended to treat all of these products as sort of the same. I heard Comptroller Dugan talk to an affordable housing audience about these lenders. These products were lenders efforts to address affordable housing issues.

Well, clearly, the interest-only product has traditionally been about increasing the ability of a borrower to qualify which is they’re going at the interest only payment. Which interest only for the longer term when you're doing interest only, in a 10-year period, it is much more likely the borrower assuming there is not an abusive practice here, where it's a borrower on a fixed income or something horrendous, but this really was used in a situation where the borrower's income would be increasing over that period as with the amount of equity in the house if they could refinance out in the 10-year period or whatever else.

That, you know, probably is a good product for a certain amount of the population.

The pay option product has traditionally been for folks who want to actively manage their finances. They are qualified at a higher -- at the fully indexed rate, not at the start rate. And it is to enable borrowers who want to access their equity and make financial decisions each month. It requires much more active management of the account.

But all of those are things that I think it is incumbent on us to help face poor attorney, have the information he needs when he's going into this. If he doesn't understand, he's going to have four payment options each month, and the impact of those payment options, he is going to make bad decisions. He is going to be surprised when he gets his first periodic statement and suddenly sees four choices.

COUNCIL MEMBER SCHWARTZ: Bruce and then Anna.

COUNCIL MEMBER MORGAN: Well, Governor Bies made about two of the points I was going to try to make. I would like to kind of agree with Mary Jane and a couple of the other commentators.

This market is growing rapidly, but there are a lot of products that are outside of what was in the guidance. And I think properly structure, addressed to the right consumer, nontraditional mortgage products are very good. And we have a couple former members of this Council in the room that do a very good job doing this type of loan.

But we need to focus on where the abuse is. And today -- I'm a traditional lender. I hold loans in portfolio. I sell into the secondary mortgage market.

We haven't talked about abuses in those kind of areas, because I'm dealing with prime borrowers. But if we focus on where the abuses are, maybe at one of our future Council meetings on Wednesday, maybe we need a panel from the Council of State Bank Supervisors. Three or four of these state regulators that deal with this and have them tell us how they use the tools of the Federal Reserve through Reg Z or whatever other means to accomplish this regulation. Because a lot of it is at the state level, through state banking departments, through state attorney generals.

And, you know, on the way up here on the airplane I was just reading about Pennsylvania's got a new law that they're trying to put in to further regulate mortgage brokers. But we got to focus on where the bad actors are. And the thing that I like about the guidance governor, is it's guidance. We're not trying to say one size fits all. Because, obviously, from this discussion this morning, there are many, many, many different nontraditional products that aren't even defined in the guidance.

And so we've got to move cautiously. Because of the growth, I absolutely agree it needs attention. And it needs further monitoring. But right now the marketplace is so far ahead of where we are in terms of regulation and these are going to pop up all the time. It's kind of like when you take your kids to the arcade and the gophers pop up. You get one, another pops up. But I do agree it's something that needs monitoring.

COUNCIL MEMBER SCHWARTZ: Bruce, in response to one of my observations is if you look at what the traditional markets have been maybe heavily fixed rate, GSE type of market share, Ginny Mae type of share. Not that long ago, very significantly kind of a vanilla market in a low-rate environment.

It's not the case anymore across the whole mortgage spectrum. And I think it's really important for our committees and for the Federal Reserve and others to recognize this is across the mortgage spectrum and there are borrowers in all sides of the equation.

And I would also suggest that not every borrower in the non-prime market doesn't get it. That's a really bad stereotype and misnomer.

I think there are people on all sides of the market, Alt-A, prime, non-prime who find the same complexities and it's dominant in many sectors.

COUNCIL MEMBER MORGAN: Well, as a traditional lender that does secondary market mortgages, you ought to see the rate sheets that we get each day from our investors. There's not one product or two products. There's like six pages of products.

It's so complex that we as a business decision have to define the market we want to be in and all those second through six pages of products say, we don't do those. But it's confusing both for the prime and the subprime and there is a whole variation of options out there.

COUNCIL MEMBER SCHWARTZ: Anna, I'm sorry.

COUNCIL MEMBER RENTSCHLER: I'm going to echo what Bruce said.

I think that this -- we're dealing with disclosures on interest only option ARMs, etcetera. But as new and innovative products are out there, we are behind the eight ball because they're already out there and the bad actors or the good actors regardless of who you're dealing with. We're talking about change. And change is difficult and it deals with financial literacy. Also proper disclosures and properly disclosing, not over-disclosing to the point of confusion.

And sometimes we get so many disclosures in their hands, they just throw them up in the air and say. I don't know what we have.

To address Governor Bies' point about the guidance. I understand that it's guidance. And I encourage you and other regulators, as well. It's not just the Fed to make sure that examiners understand that it's guidance. Because in other areas they have taken it as de facto regulations and are writing banks up in that regard. And I've seen this not just in the lending side and the BSA side and the others. We've gotten a lot of criticism because we haven't had written risk assessments on this and that and the other in some of our shops.

And I think it's very important that it's risk-based guidance and we can properly address with the examiners what's appropriate for what size bank and complexity.

COUNCIL MEMBER SCHWARTZ: I think Stella had a question or comment.

COUNCIL MEMBER ADAMS: Yes. I just wanted to reiterate that the products are not bad per se bad. Nontraditional products are just that. Nontraditional products.

But there has got to be, we can't avoid it, there's got to be some suitability standard put in place. And I'm not saying, because I know the lenders are here. They get chills in their spine when they hear that.

I'm not saying that if you get six pages, Bruce, of loan things and that you only as a rule work off of page 1 that if the customer came in, didn't qualify for anything on page 1 and there was a product that was suitable for them on page 4, that you get dinged for that.

COUNCIL MEMBER MORGAN: That's correct.

COUNCIL MEMBER ADAMS: I think, though, that if we think about in the analogy I like to use about this is that financial health. And that the mortgage broker is being looked to or the mortgage originator is being looked to to diagnose what's the best product for my financial future, financial health.

General practitioners do not do surgery. All surgeons are not neurosurgeons, you know. Even all plastic surgeons don't do all the procedures. You have specialists. And it may be that you don't go to a general practitioner if you need a specialist. And so we develop some kind of suitability standard for these nontraditional products that you have some expertise or knowledge that you can then explain the product appropriately to the borrowers.

I will tell you that in my opinion, 90 percent of the mortgage brokers cannot explain the products. They're looking at the rate sheet and working off of that. But they have no real understanding of how the pay option, the 1 percent, the 3 percent. It may be that the broker in good faith, and I'm going to be the most generous as possible here, in good faith, didn't really understand the product.

But that doesn't mean the borrower should be harmed. And there has got to be some kind of standard. You've got to understand the products you sell. I don't now how difficult a suitability standard that is. And that they be categorized. If you're a general practitioner, they're listed in one section of the phone book.

If you are a neurosurgeon, they're listed in another section of the phone book. They're not listed together so that borrowers have choices amongst specialists. And I think that we've got to go to a suitability standard for brokers.

You can't sell insurance without that suitability. You can't sell securities that way. But the biggest investment any person in this country makes is in their home. And there's no standard at all. It's ridiculous.

COUNCIL MEMBER SCHWARTZ: Stella, on that suitability.

The largest lenders in the country that dominate the residential mortgage market, probably offer just about every product out there. So, getting to like select separate groups makes that a little bit cumbersome. But it's an interesting thought. And I know Forrest had some comments. And we'll have to wrap up after that.

COUNCIL MEMBER STANLEY: Okay. You're right, Stella. I have a chill but I think it's because the air conditioning thing is right above me and it's freezing over here.

But I think that suitability is, while it has some appearance of value on its face, would actually be a big step backwards.

You know, not too long ago when there was significant fair lending concerns, it was because of all the subjectivity in the process. And to go back to all of that subjectivity, I think, would actually be, you know, the cure would be worse than the disease. I just think you would not want to have all of the brokers, bankers that are offering mortgage products making those type of subjective decisions for the customer. Steering them into products that later on can be questioned.

I think it would be quite honestly a nightmare for consumer groups. It would be a nightmare for the bankers and I think it would be almost impossible to do an effective examination. You would be constantly second-guessing decisions.

I just think it's a step backwards. I think it's well intentioned. There's no question about that. But I think practically it would be a step backwards if we went back to all that kind of subjectivity.

COUNCIL MEMBER SCHWARTZ: Stella, this is your last comment, because he ended on a really positive note.

COUNCIL MEMBER ADAMS: I really am not talking about going backwards in time. You've got desktop underwriter. All these things that kick out products right now.

I would see the big box lenders as a hospital, not as doctors. And so you would have the freedom to offer all those products under your hospital, just as medical care is given. And, you know, I'm not saying go back to the old ways. I'm saying that now the majority of the lending is not done in the hospital. Just like the majority of medical care is not given in the hospital.

And so we've got to regulate outside. We've got to make sure that the people who are offering financial services outside of the lenders on behalf of the lenders have the ability to do that in a way that protects the borrowers and protects the lenders.

Right now, the mortgage fraud problem is affecting both the patient and the hospital. And we've got to figure out a way to do it.

And I'm not saying go back to subjective stuff at all. The technology is in place. We'll pretty much pick the right loan. I mean, that's what the technology -- the desktop kicks the information out. I'm not saying get rid of those technologies that we've created that kind of do the vanilla quick and easy. But I am saying that when we go outside of the vanilla, that we need to make sure that you really understand that that's not poison, that that's really a flavoring and not poison that you're giving to a customer.

COUNCIL MEMBER SCHWARTZ: Thank you, Stella. That was a great end.

COUNCIL MEMBER SWANSON: All right. Well, that concludes our discussion this morning on the home-equity lending three topics that we had on the agenda. And we're now going to shift gears and talk about financial literacy.

And with that, I'd like to turn it over to Anne Diedrick to lead our discussion.

COUNCIL MEMBER DIEDRICK: Thank you so much.

Well, this is a topic where literally everybody in the room can get engaged because as far as I know, it's not very controversial, everyone is for it.

With that, I'd like to just start by leading a discussion point by thanking of the Federal Reserve Board for its leadership and recognizing --

PARTICIPANT: Anne, could you put the microphone closer?

COUNCIL MEMBER DIEDRICK: I want to thank the Federal Reserve Board for its leadership in speaking out on the importance of financial education as one tool in helping American households to live the American dream.

Most of you in this room know that on May 23rd, Chairman Bernanke testified before the Committee on Banking and Housing and Urban Affairs in the U.S. Senate on financial literacy.

And only last week Chairman Bernanke spoke in Texas about strategies for helping families, particularly lower-income families improve their economic and financial well-being.

Probably the Fed's most important role in supporting consumer financial education and decisionmaking is its consumer protection rule-writing authority.

As we all know, the Federal Reserve sets requirements that specify the information that must be disclosed to consumers about the terms and fees associated with credit and debit accounts. Disclosures provide consumers with the essential information they need to access the cost and benefits of financial services and allows them to comparison shop.

Yesterday we learned that the Fed is using consumer focus groups and other methods to make disclosures as clear and user friendly as possible. Today's consumer must choose among a wide range of financial products and services offered by a seemingly endless list of providers.

Some of these decisions will be life-changing. Some for the better and some for the worst.

Our discussion today will consider three questions. And briefly, they're going to be, what is the goal for financial literacy including what do consumers need to know and do and then we're going to talk about different delivery channels. And then we're going to talk about measurements and evaluations of efforts.

So, I just want to begin with the question that our committee spent quite a bit of time on yesterday. So, I know we have some answers to this one. And the question is, what is the goal for financial literacy including what do consumers need to know and to do?

This is supposed to be the easy question, everybody.

COUNCIL MEMBER WILLIAMS: Well, I can start.

I agree. I think that financial literacy training is very important. And I appreciated the support of the Federal Reserve Board in developing effective curricula and supporting this movement.

It provides consumers with the kinds of information and skills that they need in a growingly complex financial services environment. And I think our last discussion about non-traditional loans, high-priced loans, you know, really demonstrate the importance of consumer knowledge.

But also the importance of financial services and to allow people to weigh their various options.

I think, you know, one way of looking at this is that not only are we providing people with the skills that they need to effectively manage their finances, but for me, are we giving people the tools that they need to avoid high-price loans and to avoid high price financial services. That to me, I think, is a very important outcome of financial literacy training. Because the information that people are receiving really, I think, is fundamental to asset building and asset development.

As I mentioned before, part of this life long learning of financial literacy is really to help people to protect their assets and to grow their assets. For me, that's a very fundamental role.

I think that there may be a different way to look at this. And one is if we consider the efforts over the past five or so years, sort of the first phase in financial literacy, and during that phase we've developed excellent curricula.

When I first started working in financial literacy, most of the curricula was directed towards middle-income people and there were topics about, you know, investments and other kinds of options. But very little sort of very fundamental information. How do I balance my checking account. What is a checking account? What are the funds availability policies?

And so I think we've developed some great curricula that address some of those fundamental issues.

We've also trained thousands of people across the country to deliver financial literacy training. There have been networks that have been established and partnerships between regulators, financial institutions and community organizations.

I think that we're now looking at a second phase of financial literacy training. And I think that the Fed could be very instrumental in developing the kinds of information and tools that we need to go into the second phase because I think there are a number of different challenges involved.

First is, the first phase I think we were able to penetrate markets and communities of relatively low hanging fruit. People who were motivated to participate in financial literacy training. And that we need to figure out as part of this next phase how do we penetrate other markets and communities where people have not taken advantages of these kinds of opportunities? How do we reach them? How do we get more people involved?

I think it's also important to look at a nationwide strategy that provides financial literacy training in schools -- in public schools so that we start when children are very young and develop training over a period of time.

I think another major challenge of financial literacy training is that it's very difficult to use this kind of training to sort of rebut the very consumerist messages that we all receive, to buy, buy, buy to support our economy by buying. You can have it now. Why wait until you save, you know, a 10 percent down payment?

And so another challenge I think is to compliment financial literacy training with campaign messages that can look at those kinds of images and messages that people receive.

And Carolyn at the National Consumer Law Center is very involved in a national campaign that will do just that.

And I think also that for me, and this may not be appropriate for all financial literacy training, but for me, the best financial literacy training integrates product delivery.

So, when we talk to our bank partners about developing training, you know, it isn't just about, you know, how do you balance your checkbook and the importance of budgeting and savings. But, you know what, my bank wants you as a customer. And here are our products, you know, let's figure out what's the best savings vehicle for you and what your needs are. And we will value your customer -- your money in our bank.

And as I was talking before about high-price lending, I think that that starts to build that relationship that we all want to see. And that it's important as part of that product delivery to have more savings vehicles.

And then last, I just want to mention that financial literacy is part of a comprehensive approach to dealing with some of these issues that we've talked about today. But that we also need to have affordable alternatives for people so that we need prime products, prime home-mortgage products, refinance products, car loans, all kinds of financial services. But most importantly, we need to look at public policy, because that's really where you can effect and impact the greatest number of people.

COUNCIL MEMBER DIEDRICK: That was fantastic. Thank you.

Sarah.

COUNCIL MEMBER LUDWIG: Thanks. And I agree with everything that Marva said and just want to kind of give it a slightly different spin and add some things to it.

We believe that, you know, financial literacy is clearly monumentally extremely important and it's always very rewarding and exciting to see people who start a financial literacy class so you can see the sort of whole body language transform if somebody is nervous and you can see kind of intimidated and thinking, oh, God. The financial literacy is going to be so dry and threatening and boring and complicated. And then to watch people sort of relax as you make the information accessible to people and they can make sense out of stuff, much of which people already know. And I'm only suggesting, you know, people are completely confused and befuddled out there. But sort of have a sense of need to kind of get some clarification on them and be able to connect off of what they already know and make sense out of stuff.

So, that's, you know, great to watch people get an understanding and then for people for come back to a second session and say, you know, I took the information we talked about last time and I went into the bank and I opened an account. And those can be very, very great, great moments.

But I think when we're thinking about goals for financial literacy you have to really think about the big picture. It's kind of policy issues as Marva said, but it's also that, you know, there's not sort of type of or approach to financial literacy to address all of the needs out there.

There are people, you know, who are at different points, different ages, have different needs, have different reading literacy levels, different languages they speak. So, this sort of canned approach that we tend to see out there to financial literacy, I think, is really problematic and missing the mark. And it's a lot of really important precious resources going into creating template curricula when what we really need to be doing is tailoring what we -- the content of financial education to the people in the room.

So, although I agree with you we've come far way, I think we still have very far to make sure that we have nuanced, appropriate material that can be adapted to the particular situation and the people who are receiving the information.

I mean people often know what they need and so they can say at the outset, this is what I want to learn and then to respond to that with something that addresses people's -- not just walk in. This is what we're going to bring you, but this is responsive to what you're looking for.

The other thing is that, you know, in addition to integrating financial literacy curricula with sort of actual products, we think it's really important to integrate financial education with information on people's rights as financial consumers. So that any curricula that I see that doesn't have information on, you know, the Fair Housing Act, ECOA, Fair Debt Collection Practices Act, FACT Act. All of that stuff. I mean, it's not so complicated people can't understand it. And there are ways to break it down for people that it arms then beyond, you know, obviously, not only knowing that banking and checking is really fundamental, but also knowing your rights helps people, we have found, to really step up and then act on the specific mechanics of financial planning in the bigger picture of knowing that they've got rights as consumers. And that, you know, they should be protected from some of these things.

And also I think we have to address our financial education as a goal that, you know, a lot of people when we talk about asset development in other communities where almost all of the financial services are asset depleted. So, what message are we sending about savings when the vehicles and the existing community don't match up?

So, we need to really think hard. We do a lot of financial education in New York City where we'll explain to people what to avoid. And, you know, people are smart. And they say, okay. I get it. I get it. So, where do I go? You know, what are my alternatives to the payday loan. What are my alternatives to, you know, the tax, you know, refund anticipation loan and things like that if I, you know, those are the things that may not make sense once I get it with a rent-to-own store.

The other thing is, I think, in terms of our goals in financial literacy we need to try to step outside some of the roads. Broad heart-warming cliches tend to be associated with financial literacy that it's a panacea, that it lifts people out of poverty. I don't know how many times I've heard that. Financial education lifts people out of poverty.

Financial education, you know, helps people gain control. I do think that, you know, although it is very, very important and transformational for a lot of people, it's not that becoming financially literate necessarily, your economic opportunities instantly change.

And I think we need to avoid overstating the role of financial literacy. We're at many, many, many meetings with banks where we talk about their practices. We'll take tax refund anticipation loans as an example. And they say, well, that's why we, I mean, educate people about earning income tax credit. And that's why they educate people that about free tax prep programs. And that's why we have financial education programs.

But, no, we're talking about a product that you have that's actually problematic or the problem with predatory lending is people are financially illiterate. It just doesn't tell the whole story.

So, I think, we want to make sure that we don't in our setting rules for financial literacy overly shift the burden of a lot of the problems that people have on to consumers, but that we understand that some of these issues are systemic and try to help people understand the system so that they can navigate their way effectively through it.

COUNCIL MEMBER DIEDRICK: Thanks, Sarah.

Dorothy.

COUNCIL MEMBER BRIDGES: I think this is one set of discussion issues that I think a lot of the consumer groups are preaching to the choir when you're talking about banks and financial literacy. We like to call it financial education.

And let's make sure that we distinguish what we mean by financial literacy versus product literacy. I mean, that's a very, very important distinction because up until now what I've heard around the table is that those two are synonymous.

Financial literacy in my opinion suggests that people are not knowledgeable about the basics of finance. I think our schools have done a fantastic job of making people aware about the basic fundamental things. And I agree with Sarah when you talk about where people are in their life phase that the literacy or the education we need to do has to fit whatever their needs might be at the time.

I would think that if you had asked me five, maybe ten years ago whether or not we needed to talk individuals who worked at their positions and their professions for 30 years and all of a sudden are facing the fact that they no longer have pensions. What are they going to do? I mean, where do they go now? And how do you supplement income? I mean, that's a different kind of education versus financial literacy that we sort of tend to put in the bucket and say we've covered all bases.

Financial literacy or education is what I'd like to call it, is a process. It's not an event. So, it's something that is going to be required to do over and over and over again. Banks get it. We understand that. We've been doing it for a number of years. And, in fact, our trade associations around the country and across state lines have done a fantastic job of making things very effective for us. We keep our fingers on the pulse at any rate, keep our fingers on the pulse of what needs to occur in the schools with the bank's help and what are strategic alliances that we need to form in order to make sure that it's effective.

We also try to think about it at different phases of an individual's life. What kind of financial skill set is required so that they at least understand when they do get involved in a financial transaction.

Here are some basic questions that you ought to be asking and above all, ask when you don't understand. It's okay that you don't understand everything, but keep asking until you're comfortable.

And, I mean, at some point it has to be left up to the consumer to make that decision because then and only then do you get that stream of consciousness about whether or not this is the right thing for me.

As much education as we can throw at people, I'm in favor of. It's always better to over inundate people with the information so that they do have choices and they can ask some intelligent questions.

But for the most part, I think if you're asking bankers to be that person to do the education, sometimes that would be most effective. But in a lot of cases, it can't be because people are intimidated by bankers. And because somewhere somebody has done a fantastic job of making us appear like ogres in certain situations. And we have to be aware of that.

And, secondly, because neighborhood groups do a fantastic job of that. And if we could form strategic alliances and help put together curriculums to address those issues, I think that's what we're after. Because, after all, a smarter consumer makes a smarter customer for the bank. And so I think we're all on the same page here.

COUNCIL MEMBER DIEDRICK: That's a terrific segue to the next question which is what methods of financial counseling are most effective for what objectives, including the best delivery channels for reaching people at different stages of their financial life cycles.

So, I think here what we're looking for is maybe possibly some best practices as far as reaching people at different stages of their life, whether it's at the time when they are buying their first home or thinking about saving for their retirement or their children's education. How they are best reached?

So, Joshua, do you have any ideas for delivery channels?

COUNCIL MEMBER PEIREZ: Actually without knowing that was your question, I was actually going to raise the same question. And I think, you know, for us we certainly have discovered some ways, for example, trying to reach college students and having a bank do it is an entirely useless endeavor. They listen to their peers and that's it.

And so we have a program where we train college student interns who then develop the curriculum on their own campuses. It's all endorsed by the campus administration. They participate in endorsing the programs and we end up educating many more people more effectively than we could trying to do it ourselves. And they wouldn't listen to us anyway.

But I think that when you look at financial literacy, everyone agrees it's a great goal. I think any consumer you would ask if they'd like to be financially literate, would tell you they would. I'm not sure if they would admit that they feel they're not literate. And I think one of the concerns that we have is that we see a disproportionate participation by consumers in financial literacy programs once they're already in trouble.

And most of the financial literacy programs out there deal with preventing consumers from getting in trouble. So, I do wonder if there's a disconnect between the majority of the programs and the people who are coming to them.

We've launched really a first of its kind program in our industry at least that focuses. We call it that Debt Know-How. It focuses on people who are in debt and helping them get out of debt. And it's actually developed with the University of Minnesota. So, they developed the curriculum, not us, for a variety of reasons.

But I do wonder on this question as to whether we can all be more effective and targeted in the large amounts of time and resources that we're all expending in getting to the consumers who are not in trouble when they're not in trouble and getting to the consumers who are in trouble when they are in trouble. And whether, you know, -- and I think this goes to some extent to the comments I think, Stella, it may have been you or Marva about, you know, whether we just have templates that are out there. And if that's really the most effective way to get to people.

I think it's a question of, you know, if somebody is really looking at education about how to buy a home and to understand the various products that are out there for them, teaching them about how to, you know, open a checking account and manage a budget will be helpful once they're in that home. But it's not necessarily going to be helpful for them choosing the product to get there.

And so I just -- I put out there for discussion the thought of how we -- if people agree that this disconnect exists and, if so, you know, any ideas beyond some of the ones I've suggested and how we remedy it.

COUNCIL MEMBER DIEDRICK: I'm going to go to Faith in a minute, but I think one of the reasons why we're having this conversation today is because both the advocates and the bankers feel that there's a lot of financial education going on, not terrible coordinated, it's not terribly strategic. It's not necessarily reaching the right people at the right time. And I think there is a considerable amount of frustration around that. And I am including certainly in my shop.

And one of the things that I’ve been thinking about over the last 24 hours in hearing this is it’s really getting much more strategic and stopped just, you know, putting things out there, spreading it around like it’s mayonnaise in the community but saying, you know, we got to really put -- make an impact and really think through how to reach people whether they’re in trouble with the right program or preparing them at the right stage of their financial life. So, I kind of smoothed it. Faith.

COUNCIL MEMBER SCHWARTZ: Well, I think that’s a great comment, Anne, and when you find that answer out, you can share it with everyone.

Josh, I know for the housing industry, certainly it’s always important to think about the pre-credit counseling and, you know, people’s buying instincts and behavior. But the realities are often they want that first home. They want that loan. They want that money. They want that yes. And the frustration for many I suspect.

What is really impressive and great is NeighborWorks of America, NRC, the old NRC, has a great program that some of us are very active in and they are the umbrella organization for NHSs around the country. Those banks or anyone here not involved should get involved because it’s really to preserve home ownership and intervene in the foreclosure process.

But more importantly, to get the borrower to talk to a trusted advisor other than that lender where they do not want to go in and say I can’t make my payment. I don’t even want you to call me. Or they don’t open their mail. Because the truth is, if you’re in trouble, whether you’re a prime borrower or not, you know, people’s behavior changes and the last person they want to hear from is their lender.

We have had some very good experiences through NHS and NeighborWorks and they have a nationwide ad campaign being worked on with the Ad Council to kind of get this model that’s worked in Chicago through NHS and Bruce Gottschall’s group to broadly broaden it out and it’s pretty exciting and I think it’s a step forward for collaboration on this issue versus, you know, polarization on an issue that’s a tough issue.

COUNCIL MEMBER DIEDRICK: Do you want to just say one more thing about what that project is going to do? How that’s going to work for those who don’t know?

COUNCIL MEMBER SCHWARTZ: Well, it’s a little advertisement for NeighborWorks campaign. But it’s really working with the Hope Foundation and NHS housing counselors to have 800 numbers where people can call in and get referred to housing counselor if they're in trouble. Telephonic counseling. But then if they need more face-to-face counseling, the next step is to go into a housing counselor that's at the table in their city or regions. And they have been supported by four different counseling agencies like CCRC and some others.

For lenders, I know we've spent a lot of time with some of these groups to share what we can do, whether it's modification, forbearance, work outs or things to avoid foreclosures to intervene or just intermediate the problem of a foreclosure because you haven't been in touch with your borrower.

So, it's kind of a combination of, you know, advertising, bringing people to the table, not the lender, you know, but someone who can help and understand what's going on and whether it's 1 percent or 10 percent of 15 percent that get kind of intermediated so you don't have that foreclosure. It's very healthy to the communities as we all know. And they are very good about partnering with the Federal Reserve and other -- the mayors' offices in the city. So, it's been a pretty exciting collaboration.

COUNCIL MEMBER DIEDRICK: And an interesting channel and a great way and a big way to try to touch people across the United States. And give them a phone number to call when they're in trouble.

COUNCIL MEMBER CURRIE: I don't want to put a damper on what Faith said, but I know our organization was involved in an effort like that with a call-in number in the state of Texas.

And I think getting back to the whole thing of product matching up with education. I mean, our experience was yes, you can get somebody to call the number, yes, you can have a counselor there to assist them. But on the servicing end, on the forbearance end, on the paperwork end it's a very difficult transition to basically coordinate between those two completely separate entities who have their own work out systems. Have their own work out paperwork, who have different requirements for, you know, what their basically willing to offer and matching that up with a counselor that's actually competent to put that kind of a package together. Finance that kind of operation and actually make it work.

I mean, our personal experience was the servicers do an excellent job of pursuing those individuals for as long as they're able to pursue them, do a much better job than we as a counseling agency would be able to do in terms of even marketing forbearance to them. Marketing alternatives that they can pursue or whatever happens to be the case. And trying to match those two things up is a rather difficult process.

But the other thing I wanted to bring up was on the product side. I know we talked yesterday about financial literacy and how early it should start and developing role models that people can basically transfer into.

And one of the things that I personally brought up that I think is an important part that I think the banking institutions have somewhat abandoned is basically the role of a small saver and providing that kind of -- bringing that kind of product to the table that somebody who is interested in moving into the financial mainstream, basically opening up basic savings accounts, can get into at a reasonable cost, are able to put in very small amounts of money, are able to understand how those kinds of transactions work, are able to understand the rate of interest accrues. And then move into, you know, money market funds or whatever else might be available or not available.

I know it's a costly and in our particular market I think, one of the things our banks are looking to do is partner up to get and look at, can they do a community-wide, you know, community saves kind of a drive.

But, again, getting those institutions' systems, costs in place where they're basically able to offer, you know a no-cost saving product to people that participate in a program like that, I think is a challenge to the banking institute and I would like to see much more aggressive attempts either in schools or communities to basically open up that savings channel again that I think has somewhat been closed over the last few years.

COUNCIL MEMBER DIEDRICK: I just want to respond to the first part. Because I think you're so right, Don, as far as, you know, making the soft seamless handoff between the counseling agency and the servicing department of the mortgage company. It's not an easy thing.

I think on this project that Faith's talking about, one of the things that was important here was to bring the servicing people to the table and make them responsible for getting this thing off the ground with the idea and a lot of them put a lot of money up front, with the idea that they recognize that early intervention at the end of the day is going to help them recoup the money they're putting up to do this advertising, to do this 800 number.

So, it's really more about getting to people fast, you know, when there's still a lot of hope than for them to waiting around and getting their nerve up when it's too late and the sheriff is at the door.

COUNCIL MEMBER SCHWARTZ: I would just add to that, Anne, if I may, that in Chicago that the rate of foreclosure went down dramatically, I think, because of this program they attributed to the last five years of that collaboration has really impacted this foreclosure and delinquency.

COUNCIL MEMBER DIEDRICK: Sarah? No thanks. Faith.

COUNCIL MEMBER SCHWARTZ: The third question here that I'm going to turn to is the really hard question is and that's how do we measure and evaluate our efforts?

This is definitely a Fed question. Is it through macro measures like savings rates and bankruptcy rates or micro measures like individual participations and 401(k) and that type of thing.

But I just wanted to take a minute and also do another commercial. And this time it's for a press release that I saw put out by the Consumer Federation of America with American Express. And the report on the first phase of research they've done on Consumer Credit Counseling Effectiveness and the research was, just for those of you who are familiar with this organization, was undertaken by the Georgetown University Credit Research Center using data supplied by 10 leading consumer credit counseling agencies.

And this press release came out on June 12th, if you're interested. I know you can find it online. Consumer Federation of America. And I'll just tell you the three findings in this phase one report.

First, they found the act of seeking counseling is a valuable early warning indicator of financial trouble. I don't know if that's like -- the lights are going off there. But there must be more in the report.

The second part though I found rally, really interesting and useful for us at my institution. And that is that telephone and face-to-face delivery appear to generate equivalent outcomes. So, telephonic or electronic counseling apparently is as effective as face-to-face and one-on-one.

And when you think about how important it is to reach millions of consumers, because when people in our mortgage company get turned down for a mortgage and I mean we are referring them to electronic counseling so that they can get their credit back in shape.

But I was always worried about, you know, is that effective. And I'm very happy to hear that apparently this report says that that type of counseling is effective.

And the third finding in this report of which I'm sure there's lots more is that creditworthiness improved for debt management plan participants. Well, that's good news too that they're not wasting their time.

So, this question about measurements, you know, obviously a good way of measuring is to do some study and some research and figure it out. But, you know, it usually takes a lot of data over a long period of time and most of us just want try to get the information out there.

I'm committed as the Chair of this committee to ask this question and I know Stella might help us here.

COUNCIL MEMBER ADAMS: I want to answer this question and I also want to make a point. And that is that we really need to go back to what Dorothy talked about in terms of what financial education is versus product education or product literacy versus financial literacy.

In our discussions yesterday, we really talked about and Dorothy was really clear in kind of doing stages of financial literacy. And that the first stage is to teach to save in elementary school. And so where we can see the impact, because you can't measure something if you don't know what it is you're measuring for. And that's one of the problems with the term financial literacy the way we use it. It has so many separate meanings and so we don't know we're measuring for.

So, for that first stage where we're talking about financial education around how to save money, why savings are important and doing that in early -- in elementary school, the impact is to see how many kids, you know, these programs should be broadly based. And we should go back to the little passbook savings. See if we can improve overall savings in a community. Many communities are adopting this sort of My Community Saves.

North Carolina has an NC Saves Initiative, and that is a state-wide initiative with banks, lenders, schools all participating to improve and increase the number of -- the amount of savings. Well, there's a program that can be measured because it's got a purpose. It's got goals that are distinctive and measurable and is to scale.

The other phase is where Joshua was talking about where you're dealing with college-age students and managing credit. That's where they first come into contact with what is credit? How to use credit? Why credit is important? What kind of credit is good versus, you know, getting into the good kind of credit that builds opportunities for you versus taking out the bad kind of credit that may harm you. Then that can be measured as well.

We certainly have seen with the proliferation of easy credit cards on college campuses. We've seen the damage it's done. To see if the education works, you can look again to scale. You can look at how the, you know, getting the education early to freshman what do they look like at the end of four years. That's a measurable, quantifiable kind of situation.

COUNCIL MEMBER DIEDRICK: Yes. I was going to ask you more about the college and the credit cards. I know it's been controversial, but I'm going to move to Faith Anderson first and then if there's time, I'd like to know more about -- because I think that is a great place to get to young adults who we unfortunately see get turned down when, you know, they're out of school and five years out of school they want to buy their first home. They haven't been paying their student loans. I mean, they're in trouble from the first time they walked into college if they don't now that they've got to pay those loans in order to get on with the rest of their live.

Let me just go to Faith and then we'll come back to you, Josh.

COUNCIL MEMBER ANDERSON: I'd just like to echo what Donald and Stella were saying about savings accounts. I think that's, you know, very basic because as you all know, savings accounts, you can buy your first home, put your children to college. And retirement, especially with Social Security and pension, it's not just, you know, the low income, but even moderate income.

I've had, you know, a few friends who have been laid off who are middle age and one friend who, in particular, was laid off three or four times. And it seems like the more you get laid off, the longer it takes for you to find another job of, you know, equal salary.

So, I think savings is really the heart of it. And with the United States having a negative savings rate and, you know, we're so much into consumerism, that's really a great basic place to measure and to start and encourage.

COUNCIL MEMBER DIEDRICK: Thanks, Faith.

COUNCIL MEMBER PEIREZ: Yes. I think -- first I think there's a general misperception related to the levels of trouble among college students with credit cards specifically. But I think that there are reasons why that's true.

First of all, I think that if you look at the general population, college students have a lower percentage of default rate, they also have a lower percentage of paying only the minimum each month on their cards.

The main reasons for that though are they're generally given lower credit lines. They don't have income as a general matter. So, you know, they may be working or other things, but they're generally lended to in a very responsible way. And I think what you're generally seeing is people getting starter products so to speak at that point in their career.

There are also states that have mandated education for those products. But it can often be delivered in paper form.

What we've seen from Master Card's perspective, and frankly many of our issuers as well, is that you can create a life-long profitable good customer if you give them the right product and the right education when they're in college. Having someone who runs up a ridiculously high debt level that they then can't pay off, they're not going to be a customer of yours for very long and they're not going to pay you. So, that's irresponsible and frankly not good business.

So, we've all heard the anecdotal stories. I don't dispute that the anecdotal stories exist. But I think you have to look at the comparison. I think you're talking about, Stella, sort of measurable, you know, quantifiable results. You know, you can compare the college populations to the general population and see that their performance has actually been quite good. And I think that we've also undertaken some studies, and you mentioned the Georgetown CRC which has done many of these studies as well.

And if you look at those customers that get their first cards in college. And I won't ask for a show of hands here, but many people stick with that card throughout their life and never change it. Even if, perhaps, you know, later on they might, you know, think about it, they tend --

COUNCIL MEMBER DIEDRICK: Are you talking about the bank card or the --

COUNCIL MEMBER PEIREZ: The bank card.

COUNCIL MEMBER DIEDRICK: Or the Master Card card?

COUNCIL MEMBER PEIREZ: Well, the bank card, specifically. The bank may change it on them. We hope not, obviously, but the consumer, if the bank treats them well, and doesn't cause them to want to change, they generally can have a good customer for life.

So, actually, it has proven to be a very good positive channel. It's also a group of people that while they may feel fiercely independent and free from their parents or home life for the first time, it is also a group that is very focused on education. So, they're open to learning about the product that they're getting if you deliver them that information effectively.

COUNCIL MEMBER DIEDRICK: Good idea.

Ed.

COUNCIL MEMBER SIVAK: Financial literacy is obviously very hot right now and there's funding for it. There's lots of people to do it, and one of the ways as a nonprofit group that you get funding is by championing numbers. We've counseled "X" number of people. We've provided "X" number of people with financial literacy.

I think we need to embark on a longitudinal study that looks at the effectiveness of the programs, that uses experimental design and looks at the counter factual.

Beyond that, every conversation I have about financial literacy with industry folks, with nonprofit folks ends up back in the schools. We need to hit people earlier. We need to get people started.

Marva made the point about public policy and to the extent that we can take this intersection, this common point where we end all these discussions to make this a national policy whereby our children learn how to manage their money at a young age, that's when I think we've accomplished what we're trying to accomplish through this discussion.

COUNCIL MEMBER DIEDRICK: I appreciate that. I think that's a good place to end.

Great discussion. Thanks.

We now turn to the members forum which is an opportunity for a Council member to give a presentation on their work and we're fortunate that Lance Morgan has agreed to do the members forum today.

Lance is the President and CEO of the Ho-Chunk, Inc., which is an economic development corporation of the Winnebago Tribe of Nebraska and has agreed to talk about his work.

Lance.

COUNCIL MEMBER MORGAN: I'm very excited to do this. I really am learning more than I'm contributing to be honest. But, I'm good at some other things if I get a chance to show off.

Really, what I'm going to do though. These slides are broken down in two pieces. A little bit of education about tribal situations and us and then some nice pictures.

I don't have a video. I don't have the movie that Stella had but -- let me.

This is something -- we do a lot of shipment of products. And I had this stamp made up kind of specifically and there's a guy who is a senior citizen. He stamps it on every box that we ship out from the reservation. That's his job. He's actually very diligent about it.

Ho-Chunk, Inc., means Ho-Chunk is -- means people in the Winnebago language. So, we are the people, Inc., I suppose.

I run the corporation but we're very much a socialistic kind of strange place to work.

I'm going to talk a little bit about tribal challenges. I'll talk about the Winnebago Tribe in Nebraska. I'll talk a little bit on Ho-chunk, Inc., and I'll talk about what we're doing to try to kind of address some of these social kind of considerations.

I was recently told by a tribal member that I'm nothing but a hired hand in our community. And somebody challenged him. I said, that's probably about right.

Just for what it's worth, we function in the absolute worst political economic legal environment imaginable. And the United States is an economic machine. You know, the kind of problems you talk about, I wish we had. You know, we don't have a bank. We don't have anybody who wants to come to our reservation for these kind of economic issues.

And the biggest issue we have and I'm kind of zealot on this nationally, is trust land which you have to understand is that the reservation is owned by the federal government. And it's inalienable. So, it has all kinds of weird side effects on tribal economic development.

It basically insures our government to absolute poverty. We don't have any ability to put property taxes on our land. You know, every once in a while we try to do a gas tax or a tobacco tax and then somebody wants to put us in jail for that.

You know, the vista we face on the reservation is really a race-based taxation system. And it's really an excuse for the state to usually reach into it. I'm sorry about that. Reach into our jurisdiction and pull out revenue -- and the only rationality they have is because, well, one of the customers are of a different color skin. And that's the only place in America where race matters in which you pay at the gas pump or tobacco products or any other tax. So, I personally have a strong opinion about that.

If you don't have a tax system, you don't have bonds. If you don't have bonds you don't have schools. You don't have roads. You don't have these kinds of things.

We have no ability to collateralize our own land, our own product. So, what this has done, it's made tribes basically depend upon the federal government, the Bureau of Indian Affairs that primarily deals with us, pays for our schools, prison systems, roads, these kind of things. The funding is just not enough to be honest. But we have no ability locally to control those kinds of things. It also means individual poverty. Farming is actually dead on our reservation because we don't have collateral. You can do ranching, I suppose, in some places but that's not our deal in Nebraska, at least not our portion of Nebraska.

You can't go to the bank in the springtime and get a loan because you're primary asset, your land, is not available as a collateral source.

Also, over the generations, people have died without wills, so you could have a farm with 50 owners on it and there's no ability to easily consolidate that. So, what we have done, we are condemned to the bottom of the value chain. The government is kind of the lease of that land, the farmers for us because we're no longer farmers. And they make all the money. Actually, the farm subsidies typically are larger than we get off the ranch.

The no-collateral aspect of trust land has another impact. We can't get a normal mortgage. We only recently were able to get any kind of mortgages whatsoever and they're lease-hold mortgages, so these things like second mortgages and home-equity lines, those simply do not exist. We're just glad to be able to get something.

The other problem you have is when you die, you have to move out of government housing typically. And so there is no kind of inheritance of any sort. What happens is, you typically pass on a fraction at interest and you further fraction interest in the land. And so there is no inheritance, no inter-generational transfer. That means there's really no capital to do entrepreneurship. Either outside capital or things that -- land you might have inherited.

This is a little add-on, but the government systems, we didn't make them up. They imposed this on us in the 1930's. They're primarily based on the American Legion and probably function a little bit like a nonprofit. Which isn't a great economic system, I can assure you.

The place I work is the Winnebago Tribe of Nebraska. We're rural. There's a picture of some buffalo lately. That's taken right outside my office. There's a herd. Occasionally, they do get out.

We have 4,000 members. We primarily live in a town of 1,500 people, which is about 95 percent probably Native America. Our employment rate was 65 percent in 1993.

What I didn't add on here is that right now we have probably 600 more jobs than working-age people in our community. So, I mean, we've made an impact on that. We still have an unemployment rate, but we have some people committed to it. But we've come a long way in terms of opportunity.

The tribe had a little casino going on in 1992. The state of Iowa decided that it would be better if they had some too. And put them in our major market. So, it's a very, very modest operation.

We started in 1995. Our goal was simple. Jobs and economic diversification. We do nothing with gaming. One employee. I guess that was me. Four hundred thousand dollars in revenue, we have 530 employees and we're going to do $140 million in revenue. And imagine what that does to a town that had 65 percent unemployment ten years ago in a town of 1,500. Drop this into a community and you have lots of positive benefits but some strange social ones too.

We are involved in lots of different things. I think they handed out a blue thing that shows a little bit of the marketing about our company.

I won't get into it, but, you know, government contracting has been big lately. Home manufacturing construction, real estate, homes and apartment, hotels, these kinds of things. Lots of different development opportunities for us.

I think we're getting into what's more relevant, I think, to this forum.

We were having a huge economic impact and we were calling it -- but we were making a mistake, but we had this kind of Reaganomics thing going on. I know that one of the phrases, trickle down economics. And we thought if we created jobs and opportunities that everybody would benefit. The problem was that we had people in our community that didn't have the skill sets to, I mean, you talk about finances, we had people that never had a job, you know, never owned a home. No one in their family has ever owned a home. Nobody has ever gone to college. Those kinds of things.

Still 70 percent of our houses in our community are owned by the Federal Government.

What was happening was these people were mad. They wanted, you know, the communities and you'll see the pretty buildings, jobs and everyone had a better life except, they're 50 years old and they're thinking, how come I don't -- how come I'm not benefiting from this? And since it's a fuzzy political environment, I decided if I wanted to keep my job, that I should probably do something about it.

And we started a nonprofit corporation. We didn't have the money to do this ourselves. Now, the tribes have the nonprofit corporation but they didn't take what we had, which is kind of a corporate kind of thing. And we're used to coordinating businesses very closely together. And what we did is we integrated this nonprofit into our corporate strategy and we decided that that is the way that we would get the capital to make a broader impact in our community.

And we did something called the Ho-Chunk Village, was our first project. And we needed everything on our reservation. When you don't have property taxes you have about 100 years of lack of investment and infrastructure. And so, you know, we're kind of beggars so to speak. We'd go and beg for a grant and they'd give us just enough to build a road.

You know, we wouldn't have sewer lines or water lines, but we'd be happy with the road. We'd figure out to pay for that other stuff later. But we needed everything. We needed commercial space, housing space, community space. And what we did was we took our money and we invested it in a plan. We said, why don't we design our perfect community here on the reservation, what it would look like and then we'll use that to go out and raise the funds.

Now, funds are generated very randomly on the grant side for tribes. But this allowed us to use the random fund generation technique, but everything would have a place and so we'd have a cohesive whole in the end. And we wanted to make sure that we had physical design, physical activity in the design. Diabetes is a killer on our reservation and since the government was never kind enough to give us enough money for the sidewalks when we built our houses and our land issues are so complex. Our communities are very disjointed and very kind of person unfriendly when it comes to pedestrian activities. And so we designed a community that deals with some of those kinds of things.

We also had the companies that would benefit socially from the construction of these things and stuff. So, we had a multiplier of that.

This is our town of Winnebago and below. A very small community. We bought some land or reacquired, I supposed, is a better phrase. It's a lot more expensive getting it back.

And it's a 40-acre site community and the tribe actually owns the surrounding land behind it, but there was a highway there. This gives you a sense of the scale compared to the rest of the community.

This is what we came up with. A new urbanism kind of design, which is kind of popular thing now. The Robert Wood Johnson Foundation helped pay for that for us and I just wanted to mention that. And we have a highway kind of commercial park. A community kind of center, townhouses, apartments, a government center, and houses in back.

Now, these houses are not -- none of this land is in trust land. So, you can get a normal mortgage on it. You can get a home-equity loan, those kinds of things. I'll talk a little bit more about that in a second.

And it's also designed so that you can walk around to work, shop, that kind of stuff.

Here's a close-up version and I won't get into all the kind of design features, but the primary one of interest, and you can notice that you can park on the street and walk and do these kinds of things. There's a cultural center that we're building right there in the middle. And I think that's going to be a fascinating -- I have some more pictures of that in a minute.

This is what it looked like probably when we bought it. Very much a typical Nebraska scene. That's across the street from my office. Here's what it looked like probably a couple of years ago. Here's what it looked like last probably summer.

You can see that we actually have something called a Dollar General Store which is kind of like a small Walmart I think is what it is. And it's the only business in 30 years that we didn't start that was actually attracted to the reservation. It's because we fit their demographics apparently. But we're glad to have them.

If you go back a second -- if you look in the bottom corner, there's a little tower on that little building they threw in. So, we decided -- that was the first building we ever built that we'd actually put the tower on there and so we actually lose money on the lease to the Dollar General because of that tower but we don't care.

The building in the far back corner is one of our warehouses and we have a couple other close-ups of the -- I'll give you a couple of shots of it.

This is, on the first floor is entrepreneur space. On the top floor are apartments.

This building is -- we actually have the two largest internet companies on the web for Native American news and interest and kind of Native American products, and they have some of their products on the first floor and then manage it in the back and they ship out of the back.

These two buildings, this one and the one before, to give you a sense how we did it. We actually were able to find $2.2 million in funding. We borrowed a million dollars for the rest of it through a government loan program. And then we actually built it and made money and created jobs and those kinds of things.

And we don't pocket the money but we pass on the discounted rates to the entrepreneurs and in discounted rents for the apartments.

This is a new building we're building. It's the Artists' Guild and it's going to be fascinating. I don't know how it's going to work economically, but there's going to be -- they tell me -- it's going to be popular.

The flags here in the middle are where the statutes of the 12 plans of the tribe are going to go. That's one of the kind of cultural elements. And in this building you'll be able to watch people demonstrate their work. We'll have all the equipment because the individual entrepreneurs don't have the money to do that kind of stuff. And they'll have lockers and things of that nature and be able to sell their product there.

This is some of the housing. This is an old picture. We have a few more houses now. These are made in our housing factory in Minnesota, Detroit Lakes, Minnesota. Dynamic Homes.

And they have garages which, by the way, were almost unheard of. It's like, there's three other garages on our community besides this neighborhood. You know, HUD's not big on garages.

But these are all home ownership homes. This is kind of a design shot of what I was talking about in terms of the statutes in the central area. That's a little traditional house there called a Chipotokae.

These are some more shots of what it's going to look like. Those aren't painted yet. There'll be some discussions of the plan and what to do. And the buffalo right across the street. And, I think it's going to be quite the deal.

We raised $11 million in the last three years for this, not knowing what we were doing. And it's a combination of tribal grants, some other tribes, a few foundations.

These last three things are the last things I'm going to talk about.

I mentioned we almost had to go to jail because we wanted to have our own tax system. A federal judge said that was poor sportsmanship and we won that battle.

But we took our gas tax money now. We had to get into business primarily because we don't have tax dollars. What people don't understand about tribes is we're not in love with gaming or all of these kinds of businesses. We just don't really have a choice. We have to get into business as government entities because of the fact that we don't have a tax base.

And sometimes when we get successful and people resent that and it really bothers us. Because the alternative is absolute poverty. And, you know, we've tried that.

And we took this gas tax money and we divided up one penny of it really goes into the Winnebago Community Development Fund. And that provides the matching grasp for anybody in our community who wants to do something to make it a better place. And we've -- that's why the fire truck is there. You know, we've done the fire truck. We did a street in the Ho-Chunk Village. We digitized our language. We put money into the tribal colleges endowment fund. We bought the equipment for the youth community center, those kinds of things.

The other one is the housing down payment.

Now, we don't have a history of home ownership. And actually since we had no infrastructure, it was very expensive to build a house on the reservation. We were growing economically, but what was happening as a side effect, our community was disappearing because of the fact that we had to leave the government housing. We couldn't afford to live there anymore and there was no place for us to live. So, all of our top members of our community were moving out of our community, off the reservation as an unintended side effect. So, we decided that we wanted our community to be balanced out so we started the Winnebago Down Payment System Fund that you can get up to $25,000 and $30,000 if you're low income. And it's all generated off our economic activity and our tax revenue.

And we also own the housing manufacturing companies. We discount that $15,000. We own part of the bank so you can get a 2.9 percent loan. Since we developed the lots cheaply, they're $6,000 instead of the $20,000 in cost because of grant-based funding.

So, you can actually own a home, have instant equity and even parlay that into something or into a business or something you've never had before. So, it's a remarkable kind of thing that we're very proud of.

Rez Car is kind of a derogatory term for beat up car coming from the '70s or the '80s that we all know on the reservation. And this is a weird story to end on, but I think it's important.

We had a meeting where I said how come we're not selling these houses and everybody had bad credit because of lending practices of car dealers -- used car dealers. Twenty some percent interest, these kind of things. And actually said, dang it. I did not go to the trouble of building this town just so that this car company could screw it all up. So, we started our own car company. And we sold hundreds of cars and we sell them just at enough to break even as an entity and we use our banking relationships and our skill as a corporate entity to force the surrounding banks to actually give what we call non-Indian rate loans.

And we're very explicit about what we want and we will check on them. And we've pulled millions of dollars out of a local bank before because they didn't make any loans, and then they make them now. And it's proven to be good business for them because the economic conditions are so strong in our community now.

That is it.

COUNCIL CHAIR SWANSON: That was great. Thanks so much.

We probably have time for a question or two of Lance if anyone has anything.

GOVERNOR OLSON: Lance, the San Francisco Fed in particular, I think, has really taken the lead to try to find ways to perfect lien, to make collateral available so that we can overcome some of the legal barriers to lending on reservations. And I spoke to a meeting in Arizona a few years ago on that subject and it seemed to me that there was a real breakthrough that was available. I don't now how much progress it has made.

Are you aware? Is there any effort to try to move forward on that? It's a huge problem. I remember from many, many years ago that's it's been an enormous barrier.

I wonder if any progress has been made?

COUNCIL MEMBER MORGAN: Well, there's kind of constant effort going on to duplicate on the reservations some type of -- something that replicates the off-reservation economic system. So, there's probably a dozen federal guarantee programs of some sort.

But those programs are limited in scale and scope. And so, for example, you can only borrow a few million dollars under the Bureau of Indian Affairs loan-guarantee program, so that acts as the effective cap to your ability to track capital.

So, I've been a strong advocate. The problem is the fact that we don't own our own property and the rationale for it was an 1880's rationale that we were not competent to deal with that.

I think that the actual solution probably is to give us back title to our property and allow us to do what everybody else does in this country: own it, consolidate it, and borrow against it, develop it and those kinds of things.

In the meantime, those programs are out there. They're important, but they're not having -- there just never going to have a large enough impact to really affect the two million people who are Native Americans in this country.

GOVERNOR OLSON: But the basic problem of being able to perfect a lien on non-owner property that was -- I know that there was an effort to try to just address that component of it because that would at least move -- and have the courts accept that sort of a perfection of lien.

That seemed to me that there was an effort being made in that regard.

COUNCIL MEMBER MORGAN: There are model tribal UCC codes that are --

GOVERNOR OLSON: I guess that's what I'm referring to.

COUNCIL MEMBER MORGAN: Those aren't -- I mean, we don't have one and other tribes do and it's really -- it's really made no real difference. I think the more difference has been lease-hold mortgage interest on trust land to actually get home ownership.

GOVERNOR OLSON: Hawaii has -- that has worked in Hawaii, I know.

COUNCIL MEMBER MORGAN: But even that doesn't allow you to do some of the other things that other homeowners can do to leverage your capital or your equity in the home because you really don't -- there's no refinancing opportunity. There is no home-equity, those kinds of things. So, those are the almost but not quite programs.

We appreciate them, but we prefer to have a system that functions like everyone else.

COUNCIL CHAIR SWANSON: Stella.

COUNCIL MEMBER ADAMS: Why is it that the lease hold programs don't work for you the way they do for land trust off the reservation where the people -- where the land trust is held communally, but you can still create value in the home on top?

COUNCIL MEMBER MORGAN: I think they're limited in scope by the Federal programs themselves. So, I mean, those could be adapted. And those are becoming increasingly popular on trust land. We're talking hundreds a year, not tens of thousands.

COUNCIL CHAIR SWANSON: Bruce, did you have your hand up?

COUNCIL MEMBER MORGAN: Just a real brief question and it's kind of follow up to Governor Olson's question.

We used to have a reservation within our primary lending area. And the problem was the car would or truck would be titled in the state of Kansas, but if there was ever a problem, we couldn't enter the reservation land to talk to the borrower or pick it up.

Have you been able to work out with your tribe how you could work with local lenders that were trying to extend credit to people on the reservation?

COUNCIL MEMBER MORGAN: Well, we have a tribal court system that anyone is authorized to use.

COUNCIL MEMBER MORGAN: So, that's the mechanism you use?

COUNCIL MEMBER MORGAN: And we have a police force. I mean, everything else. I mean, there is a mechanism for dealing with it.

I think that was one of the excuses for the exorbitant interest rates. However, once we put a little pressure on, they lowered the interest rates and everything has been fine.

We have actually sold hundreds of cars and we have had one sort of a repossession. The guy's son just took it over. So, you know, we've proven remarkably willing to pay our bills if we think we're getting a fair deal.

COUNCIL MEMBER MORGAN: It was market rate interest lands in my example. It's just they weren't titling the autos to drive on the highways of the state because "they lived on the reservation, they didn't have to have the state title." So, it was difficult for us to perfect a position in the collateral, a lien position if the title never got done at the local county, then we were kind of --

COUNCIL MEMBER MORGAN: We actually -- we actually do that.

COUNCIL MEMBER MORGAN: Okay.

COUNCIL MEMBER MORGAN: I think that that -- every tribe is a little bit different.

COUNCIL MEMBER MORGAN: Exactly.

COUNCIL MEMBER MORGAN: And so -- and I think that's where some of the large financial institutions get weirded out because we are so unique and that's why they just throw up their hands and don't bother with us. But as we've grown in terms -- what's really happened is as we grow in terms of economic importance, we found that the banks have become much more flexible.

COUNCIL CHAIR SWANSON: Well, thank you, Lance. That was really an informative presentation.

COUNCIL MEMBER MORGAN: You all have a good state, by the way, when it comes to tribal relations.

COUNCIL CHAIR SWANSON: Thank you for that too. We're going to get quick committee reports from our chairs on what transpired yesterday and what we're looking at in terms of future topics. And first up is Mary Jane.

COUNCIL MEMBER SEEBACH: Thank you very much.

We talked about affordable housing yesterday or housing affordability if you will and we're hoping to have a more robust discussion again in October.

What we had looked at yesterday was the impact, the role the GSEs are playing and the impact of perhaps limiting their portfolio caps. What that might mean to affordable housing.

We also talked about abusive practices, abusive lending practices and how that might be impacting the availability of affordable housing and credit for it.

We're also looking forward to talking about HMDA in October. Of course, by then the Feds both paper and the data will be out so we should look forward to having a good discussion about that.

And we weren't able to hear from staff yesterday. We ran out of time. But we're looking to hear about the enforcement activities, not just to the federal regulators but we know that the data was shared with state and non-banking regulators would like to know what's happened with that.

And also we hope to get a preview of the credit model study that Glenn Canner's been working on. And I think that's going to have some interesting impact on the discussion about the HMDA data and where we move from here.

And finally we'd kind of like to look at Katrina again. By then both the -- well, the CDBG funds will be out and disbursed in Mississippi and Louisiana. A lot of the rebuilding will have happened. The deferment periods are obviously over and we'd like to talk a bit about what recovery is really going to look like down there.

COUNCIL CHAIR SWANSON: Great. Forrest.

COUNCIL MEMBER STANLEY: We discussed three topics yesterday.

First, we began our discussion on the red flag guidelines which are required by FACT Act and are designed to address risks of identity theft. Those guidelines are actually not officially out there yet because all the agencies haven't approved them. The Fed has by the way.

But we focused our discussion yesterday on two items.

Number one, whether or not the guidelines should apply to business accounts as well as consumer accounts and whether there's any evidence of identity theft on business accounts.

The second part of our discussion was on the 31 guidelines themselves and whether or not they were overbearing or effective. There was some concern expressed by industry representative that were going to be creating a whole other compliance burden. There was some sentiment from consumer representatives that there was actually too much flexibility in them and that lenders wouldn't be required to follow them.

We also had a very interesting discussion yesterday about kind of the vexing problem of consumers trying to stop recurring debits from their accounts for whatever purpose. It could be to pay for health club members. For that matter could be paid for a car loan.

There are protections, consumer protections in Reg E. The consumer just has to advise the bank to stop it within three days of the payment. The bank can require a written follow up.

The problem appears to be that the way the bank stopped them. We stopped them. Since we don't have a check number or whatever, we generally stop them by the dollar amount. So, if there's an unscrupulous merchant out there. In other words, if you tell us a dollar amount is $75 for your monthly health club membership and you want that recurring debit stopped, if the health club membership puts through the transaction at $74.99, that will still go through.

Again, there are consumer protections, but in the meantime there can be all kinds of problems.

And lastly we continued our discussion which will be an ongoing discussion about information security. This discussion was focused mostly on kind of the federal and state matrix of laws that are out there that require consumer notice and some safeguards. And also a brief discussion of some of the pending legislation.

Going forward, I think we will have a further discussion on the red flag guidelines when they're "officially out there" as well as talking about some of the problems that are being experienced with counterfeit official checks. That seems to be a growing problem out there and people don't understand that official checks are checks. They're not official cash. As well as trying to address the differences in consumer protections and disclosures, depending upon which payment system people choose.

There are very different regulatory schemes for debit products and credit products.

Thanks.

COUNCIL CHAIR SWANSON: Thanks. Great.

Anne.

COUNCIL MEMBER DIEDRICK: Thanks.

Yesterday, besides talking about financial literacy, our committee also talked about anti-competitive bank mergers and acquisitions. And we had -- we were looking at having Steve Piloff from the Board give us an entire leg-reg history of mergers in acquisitions and other things.

And we also talked about the CRA Investment Test. Specifically, what examiners look for, how they evaluate.

We talked about the community development services portion of the test and finally we talked about the impact of fair lending violations on CRA ratings.

For next time, we didn't get to innovative banking products. I wonder why?

We had a big agenda.

So, next time we're going to take that up if we can with a focus on stored-value cards.

We'd like to talk about the unintended consequences of Bank Secrecy Act and other regulations on new immigrants, particularly lower-income new immigrants.

We're obviously looking for more on Glenn Canner's research on HMDA, anything he can tell us would be fabulous.

And finally we also are interested in the influence of investments on under-served markets with a focus on CDFI and any measurements around their effectiveness.

COUNCIL CHAIR SWANSON: Great. Thanks.

And Faith.

COUNCIL MEMBER SCHWARTZ: Okay. The Consumer Credit Committee discussed four items yesterday, two of which were discussed in-depth today on the HOEPA hearings and practices and consumer behavior for shopping and nontraditional products. And how to think about them through disclosures and varying risk layering, et cetera.

We did have a presentation on the FACT Act by David Stein, in particular, to look at risk-based pricing notices and the complexity of what that means to issue a notice. The borrower gets a higher rate than applied for based on credit report information.

A pretty robust discussion on the complexity of offering credit, sometimes not just based on a credit report or other issues.

So, that's a continuation and you'll see more of that next time.

We had a great presentation from Paul Springman from Equifax and he did a great job describing how they build credit models and what goes into them and then showing us some analysis on the biases or lack of biases in the system because they are very careful about what information they collect that could lead to possible biases in the system.

And it brought a lot of questions out on how credit models are built independent of the credit reporting agencies. And Bruce asked that we add on how do businesses and banks and companies build their own models to offer credit out. So, the credit models and scoring will continue to come up.

We got a lot of additional requests to add items such as mortgage brokers. I left it on there just to say, do we have any -- does the Fed have any authority of the mortgage broker issue and how can their guidance continue to reach to the mortgage broker community?

Credit card issues. Abuses. We are going to see a film we think next time. It's called "Maxed Out" and it will help stimulate conversation on credit card issues for consumer behavior.

And last but not least, the rating agencies is an issue that Sheila has brought up from time to time and others have and we just are going to explore the Feds relationship with the rating agencies on the capital markets.

COUNCIL CHAIR SWANSON: Great. Thank you, Faith.

I just want to thank everyone for their participation. I think it was another good and hopefully illuminating discussion today.

And I also want to thank the Fed Governors for their involvement and participation once again. And, Governor Olson, thank you, in particular, since it's your last meeting with us before moving onto the Public Accounting Oversight Board.

Thank you for all your interest and support in the work of the Council. We really appreciate that.

And then finally I want to thank the Fed staff for taking such good care of us and for all your help and support as well.

That concludes our public meeting.

Our lunch is down the hall to the left.

Thank you.

(Whereupon, the above matter was concluded at 1:01 p.m.)