TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING

THURSDAY, OCTOBER 26, 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., Lisa Sodeika, Vice Chair, presiding.

Members present:
Lisa Sodeika, Vice chair
Stella Adams
Dennis Algiere
Faith Anderson
Dorothy Bridges
Tony Brown
Carolyn Carter
Michael Cook
Donald Currie
Anne Diedrick
Hattie B. Dorsey
Kurt Eggert
Deborah Hickok
Sarah Ludwig
Mark 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
Alan White
Marva Williams

Others present:
Sandra Braunstein, Director, Division of Consumer and Community Affairs
Benjamin Bernanke, Chairman, Board of Governors
Susan Bies, member, Board of Governors
Randall Kroszner, member, Board of Governors
Frederick Mishkin, member, Board of Governors

A G E N D A

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

(9:04 a.m.)

VICE CHAIR SODEIKA: Good morning, everyone. If we would all take our seats, we will get started.

Well, good morning, and welcome to everyone to our third Consumer Advisory Council meeting for 2006. Before we begin, I would like to take a moment to acknowledge all of our Governors here in attendance: First, Chairman Bernanke; our Oversight Governor, Governor Susan Bies; Governor Randy Kroszner; and our newly appointed Governor Mishkin. Thank you very much for joining us today.

Our very first topic for discussion this morning is the Fair and Accurate Credit Transactions Act or the FACT Act. The FACT Act -- On July 18, 2006, the Federal Financial Institution Regulatory Agencies and the FTC published proposed rules to implement provisions of the FACT Act that address identity theft red flags and the reconciliation of address discrepancies.

Yesterday, members of the Consumer Credit and Depository and Delivery Systems discussed the proposed regulation and guidelines, and our Committee Chair, Forrest Stanley, will start that discussion for us.

MR. STANLEY: Thank you. Identity theft is a very real problem, both for consumers and for the financial institutions. The regulations that were proposed in July require financial institutions to develop and implement an identity theft prevention program that includes policies and procedures to detect, prevent, and mitigate identity theft.

The guidelines are very specific. They are contained in Appendix J, 31 specific red flags of identity theft.

The guidelines are designed to be risk-based and flexible. We had discussions yesterday in two committees. It was a very good discussion, both amongst the institution members and the consumer groups. I, obviously, have some comments about them, but I will save mine for last and ask other members to comment first. Mark, would you go first? Thank you.

MR. METZ: First off, we support the agency's efforts to reduce identity theft. It is a true problem and a very real problem for customers, and it is also very good business for banks and other financial institutions to try and stop it.

VICE CHAIR SODEIKA: Mark, can you move the mic a little closer to you? Thank you.

MR. METZ: We also support a flexible risk-based approach, because it is a changing problem. The fraudsters are coming up with different ways for identify theft, and also our products have different levels of risk, and we do applaud the flexible-based approach. However, we feel that the red flags as written are too prescriptive and not really flexible.

As Forrest mentioned, our 31 flags -- We believe that these should be clearly stated as being examples, and also that a good compliance program does not have to include all 31 flags.

In terms of some specific comments, Section 90(d)(2)-(3) requires that institutions basically prove a negative, that red flags do not evidence a risk of identity theft. That is a very difficult standard to meet.

Finally, in terms of flexibility I would just point out two examples. In the definition of "customer" and in the comment letters, a number of the financial institutions raised issues because customer also includes business accounts instead of consumers. Well, in discussions with the Fed staff yesterday, the reason that was included was to make clear that that also preempted states from issuing laws with respect to business accounts.

So we are in favor of that. However, at least at our institution, business accounts, at least at this point, are at less of a risk for identity theft than consumer accounts. So we would really want to focus our efforts on consumer accounts and not be criticized if we didn't have a specific program for business accounts.

Finally, the red flags also talk about training. We very much are in favor of that. However, let's make it specific training appropriate to people that are actually doing the account opening and make it relevant to them rather than an across-the-board requirement. Thank you.

MR. STANLEY: Anne.

MS. DIEDRICK: I have to agree with everything my colleague just said. Chase believes that this is an important rule, but we also believe that provisions, particularly the provision of development and implementation of the program, should be revised to reflect better the agency's intent to adopt an approach similar to that in the Information Security Guideline, providing financial institutions with the ability to design a flexible and risk-based program.

The final rule should provide a financial institution with an outline of issues that should be considered in developing its program without requiring specific approaches. For example, the final rule could direct financial institutions to consider issues relating to identification verification procedures at account opening, transaction monitoring and verification, risks associated with Internet communication with consumers, or similar items. But it should not require the financial institution to take specific actions on a transaction by transaction basis.

This is the approach taken in the Information Security Guidelines. Chase requests the agency to take a similar approach in the final rule.

MR. STANLEY: Thank you, Anne. Dennis?

MR. ALGIERE: Thank you, Forrest. I just want to echo Mark's comments as well, that identity theft is a very serious crime. It is probably the fastest growing financial crime in America today, and consumers who are victims of identity theft have a long road ahead of them to clear their names, clean up their credit reports, and it is a very difficult job.

Financial institutions, too, have a -- play a very important role in not only detecting but mitigating identity theft, but also financial institutions in most cases take the hit financially. We take the losses. So we do have an interest in this to mitigate the losses as a result of identity theft.

I would hope that all banks -- I'll say most banks at this point in time have procedures and policies in place to detect and, more importantly, to mitigate the losses, and also to notify the consumers at the appropriate time.

This is where I am going to join Mark and Anne in the need for financial institutions to have that flexibility when we are dealing with flags. Many banks, financial institutions, already have those trip wires in place. Again, it is in our best interest, because we ultimately will take the financial losses.

In most cases, banks work hand in hand with the consumers to point them in the right direction, where to go for help, who are the credit reporting agencies and what they can do to not only clear their name but to work with the credit reporting agencies to clear their credit reports.

So again, the objective here is to assist the consumer in clearing his or her name, to prevent them from any losses but also to prevent banks -- to stop the bleeding from the banks as a result of identity theft. It is a very serious thing in the banking industry.

Training: We train a lot of employees in our bank, and most banks' employees are trained on everything from BSA/AML to Fair Lending. In some cases, they are overwhelmed. I think it is important that banks have a flexibility in identifying those employees within an institution, who needs to be trained, for what, regarding identity theft. Certainly, the frontline folks need to understand when a consumer comes in if indeed they are dealing with an identity theft issue, and how to help the consumer and where to go within the bank to prevent any further losses.

So I think we need that flexibility as we have in many other instances with regulations on training. But again, I just want to emphasize the fact that we do need to work with consumers. We do work with consumers, and banks do need flexibility to determine what those red flags and what priority we set those red flags at in determining whether or not we do indeed have an identity theft issue. Thank you.

MR. STANLEY: Faith? Carolyn?

MS. ANDERSON: Again, we would like to say that this is a very timely regulation, and we believe that a lot of institutions are already vigilant in trying to protect their customers or members from identity theft; because, as Dennis just mentioned, we do take the losses on behalf of our customers. But we also want to make sure that, when smaller financial institutions try to draft this identity theft program, that they don't have to be required to purchase expensive software.

That is why we strongly favor the risk-based approach that has been recommended, because it does take away from -- I mean, we are trying to be vigilant with identity theft, but you have to realize that, when programs -- you have to draft a new program that for smaller financial institutions, it does take them away from the day-to-day operations.

Also, a lot of us are required to follow the customer identification, have a customer identification program. We want to make sure that this identity theft red flag guideline -- that they don't add an additional burden to smaller financial institutions. We are trying to be very vigilant, but it can be an expensive cost, if there is more of a burden in terms of time and money.

Also, we strongly agree with having an effective training program. A lot of staff that are especially in the back office that don't deal with our members -- they don't even deal with identity theft. We don't want to make it a broad training requirement, because they will just memorize it just for that training program, but they won't be working it on a day-to-day basis.

So we strongly recommend that any training be given to those frontline staff and maybe people in security or who deal with bill payments. They are on the front line, and they are the ones that are really vigilant, looking out for it, and for those staff who have day-to-day customer contact.

Also, we are concerned that with the 31 checklist on Appendix J, while it is very commendable to have a checklist, we just want to make sure that with our examiners that the point of the gun is you don't have to have a documented reason why you didn't follow a certain red flag, so that you are not spending time on items that you know are not important to your institution, but instead are focusing on those guidelines that are reflective of your institution's risk.

Also, we would ask that for the implementation date that you give a year to 18 months for institutions to implement their identity theft program, so that we will have the time to review our operations to make sure that we are able to comply with this regulation. Thank you.

MR. STANLEY: Carolyn?

MS. CARTER: Yes, thank you. This is certainly -- identity theft is certainly a highly important issue for consumers, and I want to first congratulate and commend the Board and the other regulators for taking the approach to cover precursors to identity theft and possible risk of identity theft.

If the goal of these regulations is -- and it should be the goal -- to prevent incidents of identity theft, not just to recognize identity theft after it has occurred, this is the right approach. I, however, feel that the guidelines, as written, have too much flexibility written into them.

With the level of flexibility, the institutions covered by this can conclude that no red flags are appropriate. They get to select from the list of red flags which ones they are going to include in their program. They can also exclude many, many accounts. There is no mandate that they even include all their consumer accounts in their red flag program. They could decide not to include some.

The guidelines don't even say that the institution has to notify the consumer that a red flag has gone up. Now for some of these red flags, that is not appropriate probably, because there could be a reasonable basis to conclude that there wasn't any identity theft going on, but for some it is perfectly clear that the red flag shows identity theft.

For example, if someone comes into the institution with falsified identification information, I think it is perfectly clear that that is a red flag that requires action by the institution, and that action should include informing the consumer, and I would like to see this regulation say that, not leave it to all the institutions in the United States to guess about that and weigh all these different -- balance all these different considerations and reach a decision about that.

At the same time, there are other kinds of identity theft covered by this guidance that probably require in almost all circumstances less action by the institution. The example mentioned in our committee was when an identity theft just gets the credit card number, doesn't get other identifying information like the Social Security number, so can't open new accounts but can misuse that credit card.

For that, the institution -- I think it would be appropriate to give the institution guidance that you need to cancel that card. You need to send out a new card, and you need to tell the consumer exactly what's happened but not that the consumer has to -- but not over alarm the consumer, because the consumer doesn't really need to be on the alert at that point for other kinds of identity theft. The problem is that there has been an account number that has been misappropriated, and there are very simple ways for the consumer to protect himself or herself in that situation.

At our committee meeting yesterday, some of the institutions expressed fear that the guidelines would be treated as mandatory during examinations, even though they are stated as being flexible. My position would be make them mandatory in part. Make that perfectly clear. Make it perfectly clear that other things are flexible. I think that that would be possibly better for the institutions. It also might make it easier for smaller institutions, since they would have clearer guidance.

I don't doubt that most of the banks that are regulated by the federal banking regulators already have red flag programs and identity theft programs, but remember that this also applies to the institutions regulated by the FTC, and I bet that those are all over the board.

So as this regulation is finalized, I hope that the Board won't just be thinking about its institutions, but that this applies to a wider group.

Finally, I like the provision that the institution has to take action to mitigate -- that the institution, once a red flag goes off, has to have a reasonable basis for concluding that it does not evidence a risk of identity theft.

All that that standard is in there for is to say that -- is to determine whether the institution has to do something, and if an identity theft red flag has gone off, it is not all that hard for the institution to at least notify the consumer, to take some action. I think that is the appropriate standard for making that determination. Thank you.

MR. STANLEY: Bruce.

MR. BRUCE MORGAN: I would like to echo what some of the other financial institutions have said about flexibility. As a community bank, I have seen checklists and draft documents be used as roadmaps for examiners, and they treat it as a checklist.

What I would say about the FACT Act proposals and the guidelines is integrate them with what we already have. Most community banks know our customers, but look at what we already have to use for identifying who those customers are, the customer information program, the Bank Secrecy Act, and in money laundering Gramm-Leach-Bliley, information security, and the Patriot Act. We already have those procedures in place.

This last year the examiners issued a fairly comprehensive manual on how they are supposed to approach the BSA/AML examination process. We would strongly urge the final rule to only apply to consumers and not business accounts. We think our risk-assessment procedures that are in place there already cover business accounts and shouldn't be duplicative here.

Finally, in all of the various provisions that are outlined here in the guidelines, it sounds like some of the other provisions in these other acts I just mentioned, especially as regards the board of directors oversight.

So in the final rule, allow us to combine some of these things into a report or reports to the board of directors rather than separating this one out and have to "name a FACT Act officer" to report annually to the Board, as we now have an information security officer, a compliance officer, a BSA officer, all at the executive level.

We have to be reasonable when we propose these types of regulations, and right now things like this get proposed here, but by the time they filter out to us folks in the field and we are one-on-one with an examiner-in-charge, they don't understand what the real intent was by the policymaker.

So I'm just asking the Board to consider some of these things as you finalize the rule, and do make sure that it is coordinated with what we already have in place. Thank you.

MR. STANLEY: Thank you, Bruce. Joshua.

MR. PEIREZ: Thanks, Forrest. First, I would like to echo a lot of the comments from the industry and some of Carolyn's comments as well.

I think that I would agree with what Anne said, that an approach more similar to the interagency guidelines establishing information security standards would be more effective and more usable for institutions in this regard.

It would be something that can easily be audited and overseen. It would be something that would be comprehensive. It would be something that is a program, I think, along the lines of what Bruce has said would ultimately have been approved by the Board, but not necessarily overseen day to day by the Board, which is unrealistic to be meaningful.

More importantly, I think that a list of 31 red flags that become mandatory de facto because of the way auditors oversee them is just unworkable and not useful. However, I am sensitive to and agree with Carolyn's comments that there may be two or three that should be pulled out as critical. I just wonder what the actual implication of those two or three would be.

So for example, I agree with Carolyn, and the discussion on this was interesting. I think everyone agreed that somebody coming in with falsified documents is something an institution should definitely be acting on. However, if someone is walking in with falsified documents, I'm not even sure who you would call if you were trying to reach out to the consumer, because you may not know who it is. You've got falsified documents. You may not actually have real information to go on, depending on what exactly has been falsified in those documents.

So I think, again, any institution that opens an account on clearly or arguably falsified documents has a flaw in their system, but I'm not sure that saying they've got to find out who it is and call somebody is necessarily a useful thing, because you probably have that person trying to open an account running out very quickly, if it's a sort of face-to-face environment.

The last thing I would sort of echo Carolyn's comments on is the distinction between the real precursors and indicators of identity theft and other types of consumer harm, particularly in the credit card number scenario that Carolyn discussed.

I think there it is critically important that you are dealing with a consumer harm, certainly the risk of credit card fraud, but one that has an entirely different implication than identity theft. It is something that can be remedied quite quickly. It is something where the consumer generally with most brands will have zero liability or at least the limits that are in place in TILA or under Reg E, if it is a debit card.

In those scenarios I think what is critical for the Board to recognize is there is a difference between a card number that is known to have been stolen or used fraudulently, which clearly should be replaced immediately, and what really is the reality in the industry, which is that we are all extremely vigilant and, when we think there is any chance that an account number has possibly been put into the wrong hands or compromised, we take a number of steps to make sure we monitor that account extremely closely, and it would not be appropriate to contact consumers in every one of those instances; because in the huge majority of times there has not, in fact, been a compromise. It's just something that the industry is monitoring very carefully.

MR. STANLEY: Joshua, thank you. I just want to take this opportunity to highlight a couple of things.

I think in yesterday's meetings as well as some of the comments already this morning from the institutions, one of our primary concerns is the gap between a very well-intended regulation and the enforcement by the on-site examiners. Let me just give a very simple example of that.

There is a very benign requirement in the regulations for written policies and procedures. Banks love written policies and procedures. We write everything down. But what we are concerned about is that, by having a requirement in the regulations without a statement that this doesn't have to be centralized, today we fight identity theft in lots of different arenas, in our security department, in our technology department, in our customer identification unit.

What I am concerned about is that, when an examiner comes in, they are looking for a booklet. They are going to say, can you give me your FACT Act red flag guidelines policies and procedures, and they are looking for one manual. To create another stand-alone program which is overlapping with lots of other programs we already have in place is a concern, and that is where we are concerned about the regulatory burden.

As Dennis said and others said, we are every bit as concerned as the consumers, and probably more so, because at the end of the day the consumer is greatly inconvenienced, but the identity theft loss, the financial loss, is almost always borne by the financial institution. The thief -- We never catch the thief.

The other thing that I think has been mentioned today, and I hope we have some more comments on, is on the need for flexibility. The Board certainly states that the regulations will be flexible, but again we worry about that in the application, and let me give you another specific example of that.

One of the red flags, number 18, is for newly revolving credit card account is used in a manner commonly associated with fraud. What I am concerned about is credit card programs have very sophisticated algorithms that check for fraudulent activity. I suspect most everybody in this room has one time or another been called by their credit card company just to make sure that really is you, because they see an unusual activity on your card.

Those same systems are not on home equity lines of credit, and the reason they are not on home-equity lines of credit is that we haven't seen any experience of identity theft or fraud loss to necessitate those type of programs. I would be very concerned that this regulation would require us to institute something as vigorous as we have on the credit card side.

The reason we have it on the credit card side is not because there is a regulation, but it is because it is a real problem, and we are trying to fight it. As a matter of fact, you see some banks trying to use it as a competitive advantage. They have a better fraud and identity theft protection program than other financial institutions.

So again, I am just worried about -- If you just read the rule, I'm a little bit concerned that this will lead to much more burden and the rule will be very, very costly for banks to implement. I am not 100 percent sure that everybody realizes how much the cost would be if we had to go through and do each one of these things, either we had to implement it or we had to give documented evidence why we didn't implement it. That comment was also made today, and I think that is also very, very important.

I would like to hear from other commenters as well. Does anybody else have any other? Oh, Anna, thank you.

MS. RENTSCHLER: Thank you. One of the things I would like to say is that the ID theft is not something new that has just come about in the last several years. It's been five or six years ago, one of the financial institutions that is in the room -- I had a credit card, and I got a call and said, Anna, this is the Fraud Unit from -- and named the bank -- would you please call.

Well, I had just been to Washington and I had returned, and when I did call that Fraud Unit, they said, Ms. Rentschler, have you been to Malaysia lately, and I said, well, no, I have not; why? Well, have you been out of your local area, and I said, well, yes, I was just in Washington. They said, well, we have a $32,000 charge coming in on your account, and we think it's a little bit out of your pattern.

Well, yes, quite a bit out of my pattern. I hadn't been to Malaysia. Besides, my husband would kill me if I charged that much. But the thing is that ID theft has been around for years, and many of the banks -- most -- have been vigilant in watching their accounts and making sure that we have the proper IDs and placements and systems in place.

Because of this, I think that the banks have been watching it, and we need a flexible, risk-based program, allowable under this act. Without this risk basis, what we have is 31 checklist items that will be out of date as soon as the ink is dry. These fraudsters seem to be ahead of us in the game. I guess they are smarter. They find new ways to get into our system, and without it being a living, breathing document within our banks, all of a sudden we've got outdated programs, just because they match a regulation. So the risk basis is really important.

As Bruce said, following the CIP programs that we have in place, that I hope are working, should allow that documentation to be verified upon any account openings at our financial institutions. But I would just say and really emphasize the risk basis, as I understand the Fed thoroughly understands the risk-assessment process, that it be put into place with regard to this guidance. Thank you.

MR. STANLEY: Faith.

MS. ANDERSON: I know that you still also are working on FACT Act rules, that we are waiting for proposed risk-based guidelines, and I know that the agencies regularly review their regulations. But we would request that maybe down the road in a few years that you review all the FACT Act rules that have been implemented, and then determine what kind of burden that they have put on smaller financial institutions; because it is great for consumers, and it is great for us that there is a lot of protections, but you also have to realize that on the back end that it really is -- It is creating a burden, because it seems like every year there is major regulations that take a lot of time. But you still have BSA and OFAS that you still have to deal with, but you still now have -- You are just adding on to a lot of the various regulations that we have to follow.

We realize it is all great for consumers and we all want to protect our customers and our members, but at the end of the day it does become a regulatory burden.

Also, I just wanted to mention that Forrest touched upon the data security breaches. While this is a great program, identity theft, you know, we still have that opening of data security breaches and the financial institutions are the ones taking the losses, and not the merchant or whoever was compromised. Thank you.

MR. STANLEY: Dorothy?

MS. BRIDGES: I was at the ABA convention a couple of weeks ago. One of the things that I continually heard was this whole concept and, really, process of enterprise risk management, which suggests to me that it is a highly integrative process that banks and the industry regulators are really applauding; because what it does is it gets us actively involved and not going down a checklist, a series of checklists for each regulation we have, but to really, really take a look at how you are managing your business and where are the risks and how are you going to mitigate those risks, which I think is a lot more protective of our customers than taking numerous regulations and developing checklists to say thou shalt not and thou shall do this, negative affirmation sometimes.

I think those approaches to the way that our regulators regulate us sometimes are a little bit more risky to our customers. I would much rather have us take a look at enterprise risk management and a more integrated process.

The second issue, in addition to agreeing with the other industry presenters who talked a little bit about their concerns, I echo those concerns. But another issue that I have is the language. The reg and the red flags talk about possible red flags. That is a huge, huge burden, and that is very, very broad.

Possible could be anything the minute you walk in the door, because we really don't have any idea of what the intent of the individual is. All we can do is make sure that our risk-assessment process is known by our employees and is instituted and implemented, and where we see that there are some deficiencies, to retrain, re-educate, develop new procedures, and do the best that we can. But I would urge that the Board look at the language in those instances as well.

MR. STANLEY: Sarah.

MS. LUDWIG: We are hearing a lot about burdens, and we are hearing a lot about losses in this conversation. You know, I don't disagree with my colleagues from the industry who have spoken, that nobody wants undue burden and that I am sure that you are very vigilant. But the problem of identity theft continues to grow. It is not abating. It is getting worse.

So we need to have preventive controls out there and preventive mechanisms so that you don't incur the losses that you are getting on the other end after the identity theft has already occurred.

At our organization, we operate a consumer law hotline, got about 1500 calls in the last year from low- and moderate-income New Yorkers, and I'll tell you the top three reasons that people call our hotline: First, because they are experiencing some problem with debt collection. Either they are being harassed by debt collectors or they have received a summons of some kind, and they don't understand what is going on.

The second major reason for the calls that we get is that people have mistakes in their credit report, and they don't know what to do. The third top reason that people call is because of identity theft.

Well, the first two reasons are actually interlinked with the third reason, because a lot of people end up receiving summons to appear in court on debts that they have no familiarity with, because somebody had gotten a credit card in their name or incurred some kind of -- you know, taken out some kind of credit, and the first they hear about the identity theft is when they get the statement.

I can tell you, if we are talking about burden, there is a huge social and psychological burden, as we all know, that people experience through identity theft. We get people calling us who are terrified, because they have been asked to appear in court, and they don't understand what's happening. They take it very seriously.

We have other people who contact us, and they find out they have been victimized by identity theft when they have gone to apply for a job, and the prospective employer has pulled their credit report, and then they find out somebody took out credit cards or cellphones or whatever accounts on their name and didn't pay the debt, and it has appeared on their credit report.

It has implications for people when they go to get an apartment, if they are seeking insurance. So I think we can all agree that there is a very significant social and economic burden caused by identity theft and, to the extent to which the Federal Reserve has proposed regulations and guidelines to try to prevent these incidences, it is only a good thing.

We need to figure out a way not to make this burden undue, to make sure that the red flags are realistic, but I think that there is no question in our mind that these need to be sort of well-enforced guidelines and regulations so that we prevent something that is not abating but is growing.

MS. BRAUNSTEIN: Can I ask a question?

MR. STANLEY: Yes.

MS. BRAUNSTEIN: I just wanted to ask a question of the institutions. When customers come in and open accounts like for a credit card, do you automatically, just as part of your program, ever furnish them with information about protecting themselves from identity theft? Is that something you do?

MR. STANLEY: Dennis?

MR. ALGIERE: At our bank, for example, we do make available to customers and noncustomers brochures and pamphlets of identity theft, what is it, what you should do to prevent identity theft, and also what to do if you are a victim of identity theft, where to go. Our website includes a number of links to agencies such as FTC and other links and phone numbers to credit reporting agencies.

Whenever we give out an ATM card, we give out brochures assisting our customers on how to handle yourself at an ATM booth, and we also make available to customers and noncustomers just safety tips and how to prevent.

The big thing is, though -- and I don't disagree at all with what Sarah said. I mean, certainly we want to prevent. I'm just going to just say this, and it might be open-ended, but I don't think these regulations are going to prevent identity theft. Identity theft is going to occur, and it is going to continue to grow.

The fraudsters are getting smarter and smarter. We have to stay ahead of them. What we are trying to do here is to do two things: Let the consumer know they are a victim of identity theft to help them so they don't have to go to their prospective employer that, you know, you have a problem on your credit report, that when you are going to open up credit you have a problem. We are trying to give them a head start that you have been a victim or you might be a victim. You need to do some things.

Number two, how we as a financial institution -- how we need to operate to prevent and mitigate losses. So I think everyone agrees, there is wiggle room here, and there is a common ground here. We want to (1) notify the consumer, and (2), we want to mitigate the losses. But I don't think these regulations are going to prevent identity theft.

Identity theft is here and here to stay, and you are going to see more and more of it happening, because the fraudsters are getting smarter and smarter. Like Forrest said, this is across the board in any financial institution.

Sandra, not only is it important that our frontline folks, when someone opens up an account or takes an application for credit, we have technology people, we have our deposit operations people, our loan operations people doing a number of things that are interrelated here, and we do have separate policies and procedures in place to try to identify this.

One last comment I'd like to make while I have the floor here. The only thing that I have a concern about -- and you mentioned falsified ID, and I think Josh made a good point. When someone comes in with a falsified ID, if they are a customer of the bank, we are going to notify that customer. In many instances, it is not a customer of our financial institution. We don't know where to go to find them. We wouldn't even know where to call them.

You might want to call a neighboring bank to let them know, but are we breaking any financial privacy? Probably not. You give people a heads up. You call the police? Absolutely. Police don't know what to do with these types of instances. They don't. They don't handle this stuff.

The only other thing I would like to make a comment on is again proving a negative. We have a difficult time dealing with identity theft, but now we are also going to have to -- under this proposal, we are going to have to document that it is not identity theft. How do we do that?

We find ourselves more and more having to document the negative with a document that we didn't file an SAR. We have to document that this is not suspicious activity. Now we are going to have to document that it is not identity theft. What is that going to prove? At the end of the day, what does that accomplish? In my opinion, it accomplishes nothing.

We do have to hold financial institutions' feet to the fire that they are doing everything possible to prevent and notify the consumers, and I would venture to guess, if that is happening, it is not a regulated institution by the Fed, FDIC, OTS, NCOA, or OTS or OCC. It is probably an FTC regulated institution, if I had to guess.

MR. STANLEY: Okay. A couple of last comments. Deborah first.

MS. HICKOK: I am not a financial institution nor a consumer advocate, but just from a business perspective. I am a consumer customer, business customer of a community financial institution, and I work as a consultant to community banks, as well as a service provider.

An observation that I consistently have made over the last several years in this arena is how much time it takes community financial institutions to deal with all the different regulatory issues that are coming down and compliance and so forth.

What I am finding is that, in talking to these financial institutions, they are consistently passing over opportunities, business opportunities, not because they think it is a bad idea, but because of the amount of time that it takes them to implement, the cost that it takes them to implement, certain things like, for instance, FFIEC guidelines.

For a community financial institution, if they have a program in-house, it is very expensive for them to buy a technology for that, which is -- it's a necessary. That is something that is necessary, but I'm seeing that it is really not even the implementation, but it is the fear of the regulators, the examiners that are coming into the financial institution. They are afraid that they are going to be written up.

So they are spending a great amount of time in documenting and crossing the T's and dotting the I's, and not because it really is helping anybody or because it is promoting business, but because they are afraid of what a regulator is going to write up on their report. You know, just from a business perspective it just seems like their hands are being tied, and that cost and that expense gets passed on to the consumer.

MR. STANLEY: One of the things that dawned on me in listening to the comments is that maybe some of our concerns, the industry concerns, can be addressed in the examination manual. That is what the examiners use as their bible, and maybe some of the flexibility can just be reiterated in the manual, because one of the obvious themes is the regulations, number one, are necessary. I don't think anybody in the industry is saying the regulations aren't necessary. I guess what we are concerned about is they were much broader and much lengthier than we expected.

We have 31 red flags of identity theft. We don't have 31 red flags of terrorist financing. We have a risk-based approach, and our feet are held to the fire if we don't have a viable risk-based management. It just seemed to me it was much more than we expected, and that was why our concern about how it would be enforced.

As I said, maybe part of our answer or part of our concerns can be addressed when the examination manual is put out.

Are there any final comments? Anna? We have just a couple more minutes. Right, Lisa?

MR. STANLEY: Okay. Anna, and then Mark.

VICE CHAIR SODEIKA: Yes.

MS. RENTSCHLER: I wanted to touch on Sandy's question a little bit. We have brochures within our financial institutions, yes, that tell about identity theft. We spend a large amount of time acting as counselors for our customers, should they come in and think that their ID has been stolen or have a question about that.

I spend a great deal of time myself going out and speaking to different groups about identity theft. I've got one scheduled at a college in two weeks. I do this constantly, and then I also go to other groups to talk about this issue.

I think it comes down to a financial literacy component, that we as bankers take the time to discuss issues such as this with anybody in our community, but let's start at the schools. I know Missouri has a requirement now that you have a financial literacy component before graduating from high school. I think that is a good place to start. We bankers are deeply involved in that.

So to answer your question, yes, we are acting as counselors with regard to ID theft.

MR. STANLEY: Mark, and then Carolyn, we will give you the final comment. Mark?

MR. METZ: Okay. I guess I need to follow up on Anna's and follow up on some other comments. I think there is common ground here. But the point I really want to make is the banks really do get identity theft as being a huge problem. I mean, you see banks, as somebody mentioned, leading with advertising about how good their identity theft programs are.

It is not only regulatory risk, but we have huge reputational risk, if we have weak spots that allow identity theft to occur to our customers. So we clearly get that.

Again, going to the point of flexibility -- and I think Carolyn said this -- we've got 31 red flags. Let's make clear that we have flexibility to implement those, and if there are two or three that are clear that we can all agree on, let's put those in. But let's give banks and other financial institutions the ability to decide where they think the risks are.

MR. STANLEY: And, Carolyn, you get the final word.

MS. CARTER: Actually, these are a few other issues that -- other comments that other people's comments have raised.

Sarah mentioned cellphones as one of the areas where identity theft -- where she gets identity theft complaints. In fact, I think statistics, maybe collected by the FTC, show that cellphone -- fraudulently opened cellphone accounts are 18 percent or something like that of identity theft complaints.

As I read it, this regulation does not cover cellphone identity theft or other continuing accounts like medical services or utility services. It is limited to financial transactions. I think that is a very, very serious act, and that that should be addressed in the final regulation.

Second, there was discussion about the relationship with the board, with the institution's board. There is what I think of as a serious loophole in this regulation, because "board" is defined as if an institution -- if an organization doesn't have a board of directors -- and remember, this applies to FTC regulated institutions as well as banks and credit unions. If an organization doesn't have a Board, then board is defined to mean a designated employee.

Now I think the reason that Board oversight was written into this regulation was to mean that it should be dealt with at the highest levels of the organization. But for organizations that don't have boards, it can be dealt with by the sub-sub-sub-sub-clerk who would be responsible for devising, implementing, just the whole thing. If you follow the regulation, look where board of directors appears. That term appears in many parts of the regulation, and then think -- every time you see that, think sub-sub-sub-clerk, and you will see that there is actually a gaping loophole for organizations, which I think would be the FTC-regulated ones that do not have a board of directors. So that is another area where I urge the Board to consider tightening the regulation.

Finally, with respect to flexibility, I think that the idea of spelling out a little more clearly what the expectations are in the examination manual might be a good idea, because that tells the banks more clearly what is mandatory and what is not mandatory. But again, I urge the Board to take the approach of putting some more direction into this regulation so that organizations -- and I don't think we are talking about banks here, but sloppier organizations, probably the ones regulated by the FTC -- can't just blow this off. Thank you.

MR. STANLEY: Thank you, Carolyn, and thank you, everybody, for your comments. Lisa?

VICE CHAIR SODEIKA: Thank you, Forrest. One final comment in response, Sandy, to your question. We are a banking institute and a finance company, and we do provide brochures on identity theft to our customers who come in to apply, but also ongoing to our customers in the monthly billing statements, we provide information on how to prevent, but also what to do if you think you are a victim of identity theft.

Certainly, we do ongoing research to keep our financial literacy materials up to date and to make sure we are responding to things that are really top of consumers' minds, and along with being concerned about budgeting and saving and overindebtedness, those always top the list. Identity theft is always number three or four on the list of consumer concerns. So definitely an important topic for us all.

Okay, we will move on to the next very important topic, nontraditional mortgages, nontraditional mortgage products.

We are discussing today interagency guidance that addresses risks posed by residential mortgage products, often referred to as nontraditional, alternative or exotic mortgage loans. These products allow borrowers to exchange lower payments during initial period for higher payments later.

The guidance discusses the importance of carefully managing the potential heightened risk levels created by these loans.

Council members will also discuss proposed illustrations of consumer information for nontraditional mortgage products which are designed to assist borrowers to better understand the features of their nontraditional mortgages.

Members of the Community Affairs and Housing and Consumer Credit Committees discussed the guidance and proposed illustrations, and Kurt Eggert is going to start that conversation. Kurt?

MR. EGGERT: Thank you, Lisa. I wanted to just start out by kind of framing the issue a bit to talk about why we are addressing this important issue now.

Alternative mortgage products originally were designed for the few, for the wealthy, or fairly specific uses, but now they have come to dominate the market. Hybrid ARMs or hybrid Interest-Only ARMs are now staples of the subprime sector.

It used to be that borrowers had fairly simple choices to make. They could either choose 15- or 30-year mortgages. They could choose an ARM or not. Now they have a multitude of choices.

If you look at the illustration of the disclosures, you see that there are five choices there, but in the real market there may be 100 different choices.

What we've done is transferred, to some extent, the analysis of risk from the industry onto the consumer. So for a consumer to choose effectively among those choices, they have to be able to calculate where interest rates are going, where the borrower's finances will go, how long they will need a loan, how difficult the refinancing will be.

So the issue facing the Fed, basically, is how to help borrowers make those kind of risk decisions. So the Council has been asked to essentially address two different issues. One is the guidance in general, and the second is the illustrations that the Board has proposed and what we think of those as a way to educate the consumer.

So I would like to start by discussing the guidance in general and what members of the Council think of the overall guidance. So, Alan?

MR. WHITE: Okay, thanks, Kurt. Since our last discussion of nontraditional products, I have had the opportunity to talk to some colleagues around the country who have had actual experience with these so-called nontraditional products. What I wanted to do today is share some specific information about the so-called option ARM, now that we have actually seen how these are marketed and seen actual closed transactions.

I brought with me today and shared with members of the Council yesterday an actual closed option ARM package that was sold to a borrower in Chicago, highly problematic in a variety of ways which I will explain shortly, and the package includes the Truth in Lending disclosure, the loan application and the monthly statement.

Let me just start with a comment that I think this emperor has no clothes. This product is sold as a so-called affordability product. I don't think it improves the affordability of houses or mortgages in any way, shape, or form.

I also think that the name, option ARM, is a totally deceptive and misleading product name. The essential feature of the option ARM product, which I sort of summarized on the last page on the back of the packet, is that it is a graduated-payment loan in which the initial payment pays necessarily less than the interest that is accruing.

Actually, we are familiar with these products in the student loan world. Student loans are typically offered with either level payments or graduated payments, and it is understood that the initial payments are negative amortizing. The balance goes up, and those are typically and appropriately given to students who have good income increase prospects, and they are called graduated payment loans. They are not called option payment loans.

Every mortgage provides you with the option to either pay the minimum contractually required payment or to pay extra. Sometimes there are penalties for paying too much extra, but the fact that the consumer can choose to pay the minimum payment or pay more is not the inherent essential defining feature of this product.

So my initial comment in really drilling down and looking at this product and what it was and understanding it is that it is systematically being misrepresented in the market today.

You will also invariably in marketing and in the oral description of this product hear the sellers of the product say the minimum payment may not amortize the loan. It may cause your principal to go up. Well, that's not true. It will. It is guaranteed. The design of this product is that it is a negative amortization product for some period of time, and what we are seeing typically is a five-year negative amortization period.

This particular ARM was sold based on a monthly payment of $500, and as we know, the very complex cost information about mortgages is often reduced for ordinary -- you know, not just illiterate consumers, but ordinary working class consumers--to one abbreviated cost information point, a monthly payment, and that is the extent of the cost information the consumer can understand.

So this particular consumer, we learn on their application, was previously paying $920 a month on his mortgage, a house in Chicago, and obviously to pay $500 is better than to pay $900. Now the difficulty is that that $900 loan, as far as I know, was a fixed rate, level payment product, and this $500 will only last for the first 12 months. After five years, if this consumer pays $500, which steps up eventually, it will become $1,000; and if interest rates go up, because it is also an adjustable interest rate, the worst-case scenario payment in year six is $1,700 a month.

In addition, the $500 does not include taxes and insurance, and I think we have discussed this problem of apples to oranges and monthly payments that include taxes and insurance and that don't; and it is becoming a fairly serious risk factor in the mortgage market, because more and more mortgages do not include an escrow for tax and insurance.

It is pretty clear from this consumer's application that the $920 he was paying previously included taxes and insurance. So you have, in addition to the marketing material in the application, the actual monthly statement on the next to last page, which shows what the bill looks like when the consumer is sent this bill with their so-called payment options.

It turns out that this $500 payment is really $900 when you include his taxes and insurance. So he hasn't really "saved" anything, even on a cash-flow basis. Obviously, it is not a long-term savings product. It is a long term reduce your equity product.

The second comment I want to make about the monthly statement is that, although there are different payment options, one payment option is prominently featured, and that's the minimum payment, and that is not surprising. In the same way that credit card statements have a minimum payment, then you obviously have the option to pay more, but the information that is communicated on a periodic basis to the consumer really puts the emphasis on paying the negative amortizing, less than interest monthly payment.

If this consumer wanted to pay an amortizing payment, that would be $1,400 a month, which in his case with $1,600 a month in Social Security income is not really a viable option.

The other aspect of this, aside from the misleading sale of that low payment, is the fact that the application states -- well, two things about the income. One is it accurately states that the income comes from Social Security, which is not likely to increase very rapidly. It increases a little bit every year, but the other thing is that it was overstated significantly.

Now I don't have the information to know. There are two possibilities. One is this is a stated-income loan, so that the lender who got this loan from a broker did not know that this was not the consumer's true information. The other possibility is that it was documented but fictitious documents were created and put in the file, and we do see that happen from time to time. But in either case, it strikes me that, although most of the misrepresentation and deception happened at the broker level, the lender had enough information to have some concern about the suitability of this product to this borrower.

The other risk factor, of course, is because the principle will increase, this $150,000 mortgage is going to become a $160,000, $170,000, $180,000. The cap in the note, I think, is 125 percent negative amortization.

So the balance will increase, and that will only work -- the consumer will only be able in a crisis to sell their home or refinance it, if the property appreciates more rapidly. So there is an inherent assumption for these products that property values will keep going up.

I will share with you that I called one of these companies that advertises -- or a broker who advertises option ARMs, so-called option ARMs, and he explained to me, the reason these work is because property values go up 15 percent a year. So your equity will outstrip the increase in the debt.

I thought that was a wonderful example of using past results to predict future performance, which we all know is not a very reliable method, particularly in this market.

So my concern about these so-called option ARMs is that they are growing hugely. There is a newsletter called "Inside Alternative Mortgages" that reports that for the first six months of this year, option ARMs accounted for 9.2 percent of all single-family residential mortgages, almost 10 percent. That, by my calculations, is an annual rate of about $270 billion.

The story that the industry tells that these products are a response to consumer demand -- I just don't find that convincing, that suddenly all the consumers who used to borrow either fixed-rate mortgages or somewhat traditional ARMs and who wanted to have mortgages where they paid down their balance now want a negative amortization product. I just don't believe that there is a consumer preference that is being revealed by that phenomenon.

I think what is happening is that we are reaching the end of a cycle of growth, both in property values and in mortgage originations, and there is sort of a level of desperation to try and keep that volume and that growth going, and the only way to get people into mortgages that you can qualify for on some level is to have a negative amortizing product that won't ever repay the balance.

I think these are tremendously dangerous and risky products from the consumer's standpoint. I am not a sophisticated enough economist to tell you what the systemic risks are. I think they are probably there, more for the bond market than for regulated institutions. But I know that for individual homeowners there is a huge risk that is being created here of foreclosures.

It strikes me that, if the products that we saw originated in 1999 and 2000 are going into default and foreclosure at the rate of 10 percent over the life of the loan pools, that we are going to see default and foreclosure rates higher than that with these products.

So where that leaves me in terms of both the Board guidance and other steps that ought to be taken: I think the Board guidance is very valuable, very helpful. Clearly, this particular transaction violates the Board guidance in a number of ways. It is my understanding that this particular lender has already -- it has been pointed out to them, and they have taken some remedial actions. I am not sure to what extent that will solve the problem.

I think there is a deeper problem of systematic, deceptive selling of this particular product. I think that -- and I was encouraged to hear that the Fed staff is talking to the Federal Trade Commission about this product, because the advertising that I see -- I brought one, which I won't pass around, but the advertising systematically focuses on this initial payment, which is a negative amortizing payment, does not disclose in any meaningful way that the payment will go up, has to of necessity go up, go up dramatically, and the true nature of these products is not being explained or disclosed to consumers.

I think that it would be very easy if any of the agencies wanted to engage in a systematic enforcement plan to look at the marketing and the selling of this product and to take a lot of serious enforcement action.

The other suggestion I would make is that, because the guidance only applies to the supervised institutions, and the problem has been pointed out and I am sure we will talk about it some more, and it doesn't apply to the finance companies and so forth, one way to deal with that perhaps is to talk to the Federal Trade Commission about doing an advertising guide.

The FTC publishes in the Code of Federal Regulations guidance on marketing of specific kinds of products. They have one, you know, for funeral parlors, and they have one for -- They have a whole variety of advertising guides. They haven't written one in quite a while. But there is no reason that they couldn't produce a marketing guide on negative amortization loans or graduated-payment loans or whatever we want to call these that addressed some of these serious problems, I think, in the misinformation that is being used to market them.

MR. EGGERT: Okay. Mary Jane?

MS. SEEBACH: Yes. Thank you. We, of course, are actively working with our primary regulator to interpret this and make sure that we are applying it consistently to our operation. The Federal Reserve showed up on Monday for a full examination on this product.

So we will continue to explore how it is going to apply to our guidelines. I think what is most interesting to note, though, is that I have heard from a number of sources that there won't be an impact necessarily on the secondary market for this.

It was interesting from the Bond Association. We generally heard that this loan that is being sold into the market is sold as whole loans into hedge funds and other places.

Also, I would note that out of the top 25 lenders of this product, there are about 12 that are not subject in any way, because they are not in a holding company and they are not otherwise regulated; and all of these have the ability very clearly to securitize these on their own or sell them into the market.

As Comptroller Dugan has noted, this guidance will never touch them. They are not selling to any of us. So I think there will continue to be a very strong market for the product as it is available today, and I actually -- In our case, the pay-option product is a prime product with, on average, a very high FICO score. It is used in a different way perhaps than the example we were just talking about.

I also -- we are coming clearly -- so you have to assume that I am going to the level playing field argument and, you know, gosh, why can't everyone play by the same rules. I think it is important to note: We understand that the CSBS is moving to try and make something available to the states.

It is very important to understand that the state examination as it exists now in the majority of states for licensed mortgage lenders do not have a safety-and-soundness component. They don't normally have underwriters who are coming out. They do have compliance examiners who come out and look for TILA and RESPA and that sort of thing.

So the ability for them to come out and actually start working with lenders on underwriting standards is going to take a while to unfold.

We also have to assume -- You know, right now we are looking at different interpretations by the three federal regulators, three main federal banking regulators, on how this guidance will apply. Some of the other banking regulators are pushing hard to say that the guidance as written is going to apply to hybrid ARMs without an interest-only feature, so in other words, fully amortizing payments with no deferment.

It is our understanding that that is not true, and there is already enough discussion up on Capitol Hill and other places to say, well, that's not what was represented to us by the banking regulators. So my only point there being, if there is already that sort of buzz and the advocates have a concern about 2/285 -- so I mean, that is a valid issue, but there is already that sort of discussion about the guidance not being interpreted evenly between the three regulators.

Imagine when we go out to, I will say, the 32 state regulators who actually have examination protocols with the regulated lenders, it is going to be something of a free-for-all. We would assume there will be features that will be pulled in that were clearly not ever subject to the guidance at the federal level, and lenders like myself who are subject to both will have to cope with that. That is a very difficult thing for us to do.

I will say that I think this Council and, I think, everyone here today has said repeatedly -- and I'll just start it off. It is a precursor to our discussion generally about disclosures. One of the most important things that has to happen is Regulation Z quickly has to be amended on a separate track to deal with very full disclosures on these products or any other products, the hybrid ARM, anything else that seems to be raising concern in the market as it has become more dynamic.

That at least will ensure that all creditors offering this product are offering the same and most useful information as the federal regulators see it appropriate to address the points Alan was making and, I think, a number of people will make.

Right now, without that level playing field, they are going to continue to be -- To the extent that this product is so readily available to the full length of the parameters, there will be a lot of consumers who will still be drawn in on advertising that is misleading.

MR. EGGERT: Governor?

GOVERNOR BIES: Can I just -- Mary Jane, can you just clarify the comment you made about the federal regulators interpreting their recent guidance differently? Can you say a little bit more about what you mean by that?

MS. SEEBACH: There is a general -- a definite perception that the guidance has been extended to cover a 2/28 ARM without an interest-only feature. I am having an ongoing discussion with folks on Capitol Hill about this, that apparently in meetings with them up on the Hill, it was represented it went further.

So I mean, I think it is an issue that will be addressed. It either is or it isn't, and I think the perception is, even if it isn't, the regulators are going to consider how to address that issue.

GOVERNOR BIES: Well, I guess -- let me just make -- Since I chair the Sup and Reg Committee as well, we titled this Nontraditional Mortgages. There is no way we can today anticipate every new nuance of product that could be created, and you know, we are trying to set a framework here of principles that we would like to see followed, no matter what the next product is.

While we reserve the right to come in and add additional guidance, I think any product that has negative amortization features --

MS. SEEBACH: Absolutely.

GOVERNOR BIES: -- or some of the abuses that we see in these option ARMs, I view the way I perceive the way we have written the regulation and the guidance that it would encompass those same kind of features.

Now if we've got -- If you are hearing inconsistencies between the agencies, that is something that we all need to know about, because we are trying to train our examiners to deal with this consistently.

MS. SEEBACH: Absolutely.

GOVERNOR BIES: So please let us know, because at least among the federal regulators we are trying to get consistency. Again, your point is well taken on the states, but they are going to try to copy whatever guidance we do at the state level, at least for the ones who do do exams.

MS. SEEBACH: I see. So the point is I think that the guidance is fairly clear. It pertains to products where there is potential for the deferment, and a 2/28 without -- in other words, a simple -- It is fixed for two years and it re-amortizes, and it goes to either a six-month ARM or whatever happens, would not be subject. There is no deferment.

That is the current issue, because the majority -- Well, for the longest time in the nonprime market especially, a 2/28 is the primary product, and there is a shift in that. It is not quite as true anymore, but as I read it, the guidance would not apply to that product anymore than it would to a 3/27, a 5/1. I mean, the example given in the actual illustrations of a 5/1 ARM, to the extent there is full amortization, the guidance would not apply.

GOVERNOR BIES: In terms of there is no deferral, that's true. But, remember, part of the guidance also says, if you have ARMs, that you need to think about what happens when interest rates change. That is part of the guidance. So ARMs, from a safety-and-soundness perspective, you do need to consider the impact of changing interest rates. You can't ignore that.

MS. SEEBACH: Right, and I -- I mean, I think the industry generally does, but to the extent this now involves clear underwriting guidance, is it your position that it applies to all hybrid ARMs then?

GOVERNOR BIES: Well, I think we need to have -- I don't want to hold this meeting up. Let's talk some more. But again, we were trying to get the concepts out there that anything that defers or anything that has variable payment, that all of that needs to be taken into account, no matter what the exact features of a particular product. So let's talk about it.

MR. EGGERT: Paul?

MR. SPRINGMAN: As Governor Bies mentioned, new products are going to be created constantly. The market has a need. It is going to evolve, and in many cases they will start with a good purpose. There will be bad characters, Alan. To your point, they will mistreat or misuse a certain product.

Yesterday we looked at an example of what the Fed put together of comparing products over time where we looked at what the initial balance was in different scenarios for a fixed-rate loan, for various ARMs, and we looked at payments in the initial payment, future years where interest rates would go up, what the principle is going to be after a given time period.

I think there was uniform consensus that the type of framework makes sense. How you present the products -- there were questions about clarity, but overall the direction was very good in showing a customer what product they were going to take and other alternatives to make sure they are at least looking at the right decisions before they select the final product.

So directionally, I think you are going the right way.

MR. EGGERT: Stella?

MS. ADAMS: As you know, the nontraditional guidance is close to my heart. It is critically important to consumers that -- I want to talk a little bit about the illustrations -- that the information that is conveyed to consumers about these types of nontraditional products is done in a way that brings clarity and highlights for the consumer the key features; because when they are sold -- and we've done lots of testing of how these products on the pre-app stage of how these products are marketed, and they are not explained in terms of the downside. It's a small initial payment, and don't worry about it; you can refinance at a later date. That is what they are told: Don't worry; you can refinance at a later date.

In all my time working and counseling people, there has only been one couple that came to me. That was where an Option ARM was actually an appropriate alternative for them after my two-hour lecture about how they couldn't start spending this extra money they were going to have. They had to understand that someday it was going to go back into the mortgage.

The key piece, to me, about the disclosures in the illustration is that it needs to be simplified, and it needs to highlight the change, the extra amount, that is going to be required each month to make the payment.

So that if you have a payment that is $600 and it is going to go up to $1,200, that you say that's 600 extra dollars a month that you will need to have in income in five years, in two years, in three years, in order to make that payment. The illustration, I think, really needs to be simple and bold about what that monthly payment difference is going to be when it recasts and resets.

The real concern I have -- and I guess I was going to comment that I was concerned that the guidance didn't cover 2/28 products, but I take that comment back now. You know, I think that 2/28 should be covered in the guidance, that it should be taken into account, because I think that is where we are going to see the greatest increase in foreclosures in the next six to eight months.

In North Carolina for October -- not for October; for September, we had the highest increase in foreclosures in the country, and a lot of that was due to 2/28s and those kinds of products. The pay option loans -- people do not understand them. They do not understand the advertising is for we can show you how to buy this much house for this amount, or you can get this much house for the same amount, come see me and let me talk to you about it.

So for $500 I can get 1,000 square foot house or I could get a 2,000 square foot house for the same price. That sounds like a deal to me, and it is never really explained to them what the consequences are down the road.

I think this guidance is in the right direction. It does need to -- I agree with Mary Jane that Reg Z should be implemented more quickly to get the disclosures, once we kind of finalize what they are going to look like, out so that it covers the entire market and protects more folks.

I think there has to be coordination with the state examiners and with the FTC. They have to be more focused and more involved in this issue, because we are facing a foreclosure crisis in a low-interest-rate environment. It doesn't make sense.

One of the reasons these foreclosures -- or these products are out of control, and there is a need, a real need, to coordinate activities.

MR. EGGERT: Mark?

MR. METZ: Yes. A couple of comments related to what Alan said.

These products -- I guess I first want to make the point: Specifically, the Option ARM -- that is not necessarily a new product. There are certain institutions -- I know of one very well that has been offering this since 1981 and doing it very responsibly and not having the kinds of problems that are being written about and are being discussed.

So I guess my point is it can be done well. It is not for everyone. It has to be responsibly underwritten and properly disclosed. In terms of the guidance, I think the Fed is on the right path with that. I also think the illustrations are on the right path with that.

I have some specific comments on the illustrations, but I guess before I get to those, I just want to follow up Mary Jane's comment.

We do need a level playing field. The amendments to Reg Z, I think, would help that, and the sooner that is done, I think, the better.

In terms of the specific illustrations, again I think those are on the right path, specifically Illustration 1 which is a narrative, and which clearly spells out different issues and asks good questions: What can happen to your payment when the rate changes?

I think Illustration 3 is a good example, too, because it is very clear. It shows what the different payments are. I do have some concern about the Illustration 2, which is the chart, and we talked about this some in our committee yesterday. I am not necessarily saying that all charts are a bad idea. I think it is hard, though, to capture the essence of these products and explain them well in one chart where you are trying to compare different products.

The Option ARM in particular is a very complex product that is not easily described, I think, in a chart. I think you need a narrative as well. So I point to that.

I also think that there can be abuses with that chart, that unscrupulous lenders, if they want to favor one product over another, can show a very low teaser rate to sort of steer people toward that, that doesn't really highlight the payment shock that might happen. So I just have some concerns about the second illustration.

MR. EGGERT: Anna?

MS. RENTSCHLER: Thank you. As a community bank representative, I am really concerned about this. One of the things that -- and I don't disagree that there are some bad actors out there that have really taken advantage of this situation. I agree with that, and there are some banks that do that as well. However, as I said, on many occasions we act as counselors, but there is no longer a level playing field.

I would echo Mary Jane's comments about it needs to be put into Regulation Z so everyone plays by the same rules. One of the things that I think that would happen is, by not having the same rules apply to everyone and the bad actors or those brokers -- and I apologize to those good brokers by saying, though, we effectively drive them to someone that will take advantage of them if we confuse them by adding additional disclosures that aren't effective.

I agree with Mark. A lot of the disclosures are effective, but I think we need to cautiously look at that and incorporate it in Reg Z so it applies to everyone. Thank you.

MR. EGGERT: Faith.

MS. SCHWARTZ: Thanks, Kurt. I just have a few comments on the disclosures. I think it is a great first step, and I think it is one of the missing links to what the consumer gets on the front end of the business, regardless of what segment of the market you are in; and a comparison of short term ARMs, even the most teased ARMs that are in the market today, with a hybrid three- to five-year ARM and a fixed-rate loan is a great way just on the dollar amount alone to show customers the different options today, if they qualify, for instance, for those loans.

I would add, and I think this is an important component, the escrow/non-escrow piece to that, because it is one of the worries that people have on the front end where shopping is not apples to apples. I think Alan kind of indicated that. I think that is a very smart thing to do, again across the whole market.

I, like Mary Jane, have some further questions on the guidance and the breadth of all ARMs, and I think that there has been a large amount of ARMs in the market. So if this goes across all ARMs that are fully amortizing and with no negative amortization and no interest only -- and I'm talking about the whole market, not just 2/28s -- I think the whole purpose of ARMs was to qualify people who didn't qualify over the years that I have been in the business perhaps for that fixed rate. Maybe it's a five-year ARM to get them in the door, and it adjusts, and it has been sometimes different than the fixed-rate loan.

So I think, if it applies to all ARMs, it is important that the market understands the breadth of the guidance, because that will have a pretty big impact, I suspect, on ARMs. Thank you.

MR. EGGERT: Carolyn?

MS. CARTER: I want to congratulate the Board for its focus on this growing problem. It is important to have recognized the problem, and the guidance pinpoints a lot of things that need to change.

I fear, however, that the guidance won't accomplish its purposes. First, it is not mandatory. Second, it is not enforceable by the people it is intended to protect -- that is, the consumers who are entering into these mortgages. Third, it doesn't cover non-federally regulated lenders, and I fear that that means that the problems that you are concerned about will just -- that this part of the market will just move to the non-federally regulated lenders more than it already is.

So I don't want to sound like the broken record, but I will say what the others have said, that I really hope the Board will address this through Regulation Z and do it right away. I know you've got a closed-end review scheduled, but I think that some of these problems could be addressed through smaller changes to Regulation Z now, and I would urge the Board to start a separate undertaking to try to get rules in place by next October.

What I would urge the Board to do in terms of disclosures is require worst-case scenario disclosures, specifically focusing on the payment amount, and not just for the nontraditional mortgages but for all ARMs.

ARMs disclosures now are just woefully inadequate. They don't give the right information, and they don't come at the right time. We need binding disclosures of the terms, including the worst-case scenario, before people enter into the product, and they need to be transaction specific so that they are not asking people to do math in their heads. I urge the Board to look at that right away.

The other reason that that is important is the guidance does talk about disclosures a little bit. It says that lenders could, for example, give consumers some information about the maximum payment in the worst-case scenario, but it doesn't -- First, "could" is a very weak term.

Second, it doesn't give any -- There is no uniformity. It could be disclosed in any number of different ways, any number of different types of worst-case scenarios. So apples to apples comparison, comparison shopping would not be fostered by that.

Second, I urge the Board to look at its authority under 1639(l), which is part of the Home Ownership and Equity Protection Act that gives the Board broad authority to regulate abuses in the mortgage market.

In my view, that gives the Board authority to extend not the parts of this guidance that are not confined to disclosures, but go beyond disclosures to underwriting and deception. Extend those to all mortgage lenders, federally regulated, not federally regulated.

Yes, the FTC could adopt nontraditional -- could adopt advertising guidelines, but the Federal Reserve Board, in my view, could do just as much and, in fact, more because putting it in Regulation Z makes it a much more powerful tool, because that Regulation Z is enforceable by consumers. So people who are actually on the receiving end would have some redress if the Board would put it in Regulation Z.

MR. EGGERT: Thank you. Faith?

MS. ANDERSON: I would like to commend the Board and the other agencies for tackling this difficult subject and for doing it, I would think, rather quickly, too. It seems like I first heard about Option ARM loans last year, and it took a while for me to understand the negative amortization, because I am so used to paying, you pay principle and interest on a monthly basis; so how can you be losing money on your house payments.

So I think that, when you have the pressure of the desire to purchase a home, especially if it is your first home, and you just see that monthly payment, as Alan mentioned, and you don't realize that that monthly payment is the lowest possible it could be, but that you could still lose your home while making those monthly payments, I think that education is so important; because it is a complex product, and it is difficult to understand.

I also would like to comment the Board and the agencies for the illustrations. They are very helpful, and to the extent that illustration 2 that had all the different numbers with the comparisons of the different features, that you could make it simpler and easier to read. I think consumers would, hopefully, understand it better and realize what they are getting into.

MR. EGGERT: Okay. Edward?

MR. SIVAK: I think Faith read my notes. A couple of things: I really was pleased with the guidance in terms of offering some direction, and really appreciate the illustrations, because I think that shows the translation of guidance which is offered to lenders to how it affects the consumers. Hopefully, consumers will look at these illustrations.

I think the illustrations need to accomplish two things. The first is what questions do I need to ask if I am going to be purchasing a home, and how do I interpret the answers?

I think that some of the things that need to be part of that combination are what is a monthly payment going to look like, and this is going to include taxes and insurance, and some people have mentioned that. And also, what is the worst-case scenario, and some people have mentioned that as well.

So those are the main things. The reason why I focus on payments is the research shows that the low/mod end of the market or even other parts of the market, people shop on a payment. It's not the total value of the loan. So we need to make sure that people understand what that total payment will be.

Also, it is also shown in the way it is marketed. If the payment is marketed, that shows you again where the psychology is behind how people are shopping.

So those are the main things. Then just finally on Illustration 2, you could really turn that into three illustrations. You are basically comparing four different products, and I think it is important just to compare one and one, have that fixed rate, 30-year mortgage, and then compare a 5/1 ARM, then include a different illustration that may include that fixed rate again, and then compare it to an interest-only, again trying to simplify it so that it is something that a consumer can use to make a well-informed decision.

MR. EGGERT: Okay. I would just like to make a comment myself. I think the challenge of this is you have these very complex options given a consumer, and the Board is correct in trying to say how can we disclose to the consumer in the best possible way.

Normally, when you are talking about consumer disclosure, I say simplify, simplify, simplify, because you have to make it simple enough for the consumer to understand. Here, though, there is a hazard in simplifying too much, in that the product is so complex that, if you simplify too much, you are not disclosing the product effectively.

So you need to have the disclosures somewhat complicated, but I think another message that should get out to the consumer is, if you don't understand the complexity of this product, you shouldn't buy it. I think the disclosures so far haven't gotten that message out well enough, that consumers shouldn't be getting into loans that they don't understand. Lisa?

VICE CHAIR SODEIKA: I think I would be saying the same thing, but I would say simplification with clarification. I think, if -- and this is really difficult to do -- you're right, Kurt -- when we have such complex products, but if we say what are the three things a consumer needs to know, why are we even talking about these regs, it is really because the consumer needs to know their payment could go up. Their payment could go up, to sell this point, by $800 a month, and can I afford that in 24 months when that happens or whenever that happens?

If we were to pick the top five things a consumer needs to be aware of when they are looking at the loan and be able to say to them, and guess what, our typical loan will go up by $500 based on past history or based on current performance of the portfolio, something really real that someone will read and understand -- When I look at the illustrations, as well intended as they are, two pages worth of charts and numbers and information on interest-rate adjustments, it is not clear to me and is not helpful in terms of what we really want to communicate to consumers.

MR. EGGERT: Tony.

MR. BROWN: I think I am going to share my comments from a perspective as a former banker and presently as a developer. I think that the Board's guidance and the focus on underwriting standards is probably the best way to focus. I think assessment of portfolio risk and management will continue to force the financial institutions to focus on whether or not they are putting -- they are providing the right product to the right customer, and I think any other more stringent guidelines, I would just caution to be careful that we don't reduce the availability of credit as we try to mandate how certain products are to be underwritten.

I think that a consumer, once they identify the house they want, affordability is typically defined: Do I have the cash to meet my down payment, and can I make the monthly payment? I think that they probably understand the risk of the ARM, but once they are told that they qualify for the mortgage, I think that the issue of disclosures -- and I would say to the Board and to my colleagues on this committee, we just got to be cautions and realistic about what we think disclosures will do; because I don't think the consumers will read them.

I think that, in the end, they typically understand the risk, and we just simply can't regulate financial literacy. I think that that would be the danger of trying to put too much behind the issue of disclosure when consumer behavior, particularly for buying a home, can sometimes be financially irrational.

MR. EGGERT: Bruce?

MR. BRUCE MORGAN: I would like to again thank the Board for approaching this as guidance and with some clear, easily understandable illustrations of disclosures.

As a community banker, 70 percent of my loan portfolio is real estate. We have one- to four families we hold in portfolio. We do secondary market loans. As I said before, some of these obscure, nontraditional products, we don't engage in.

I am not aware of a financial institution at this table that underwrites loans to have net charge-offs or to underwrite loans to have adverse impact on the consumers. We all have reputation risks, and that is very, very serious, and we have to have customers to survive as financial institutions.

The only thing I would say about the disclosures is it uses a loan example, I think, in the Illustration number 2 of 180,000. I think we talked about maybe using 100,000, something that is a simple multiple that could be applied to other parts of the country, because we have rural banks in America that make $40,000 loans. We have banks in California that make $4 million loans.

So if we are going to have an illustration, let's have something that can easily be calculated from one market to another.

My only final comment is I applaud the efforts of the Board in working with the Council of State Bank Supervisors, and I think, if through Governor Bies's work with FFIEC, we can continue to do that so that these nontraditional mortgage guidelines are drilled down to the states that actually license and in some cases supervise mortgage brokers -- The financial institutions -- We are trying to be good actors, but there's bad actors out there.

So I think the collaborative work that the Board has already initiated with Neil Milner and that group is very positive, and I would encourage you to continue it.

MR. EGGERT: Hattie?

MS. DORSEY: First of all, I want to say thank you for taking a look at this product ARM. I think that we in the universe or in the United States ought to be concerned on a broad scale about the level of foreclosures attributed to the ARMs that are now in the marketplace.

My concern is about one of the concerns that you have voiced oftentimes, is around financial literacy. Financial literacy oftentimes is passed on to the consumer. I would say financial literacy ought to be passed back to the banking community as well. The financial institutions oftentimes do not go to the length I believe is necessary to inform the consumer, because they don't understand it themselves, and especially the people who are in the first line of marketing the mortgages to the customer.

So I think that financial literacy needs to be on both sides of the fence.

The other is that the statement has been made that ARMs are not for everyone. ARMs used to, once upon a time, especially the interest-only ARMs, were marketed to the more affluent or to the people who were in corporate jobs that were transferring every other year, and so it made sense for them to perhaps look at interest-only loans for the short term. But for the long term, I think that it is a trap, especially for the low- to moderate-income buyer.

The low- to moderate-income buyer is thinking only for that first time buyer of getting into the house. They are not looking at the downside. They are not looking at the stagnant incomes that we face in the country today.

So we don't have a mechanism -- and I applaud the mechanism that you are recommending -- to be a part of the disclosure about ARMs and where the customer would end up at the end of the day.

MR. EGGERT: We just have a couple more minutes. So Mary Jane, and then I will give Alan the last word.

MS. SEEBACH: Thank you. I wanted to go pretty specifically to Illustration 2, which I actually like the format of showing the payments this way. I would agree with Stella's comment, that I think we need to do whatever we can to dramatically highlight when there is a payment increase.

For example, the bottom one asks a simple question: Have you reduced your loan balance after five years? Yes or no? That is very dramatic. You get it right off, and I think the same thing to Stella's point. If the payment is going up $600, it is much easier to say, you know, your new payment would be X, which is -- you know, somehow really -- because when you look at all of these numbers, they all sort of look alike at some point, you know.

I also agree with Ed that I think there is a difficulty in comparing multiple products this way, and I think the important thing for me is that, as I said earlier -- I mean, interest-only is viewed as a feature. I can get a fixed-rate loan. I can get the feature of having an interest-only structured payment.

Those are two potential possibilities that I should consider when I am thinking about a fixed-rate loan. Maybe I wasn't -- Before I leave that point, though, but I think it is important to understand to make sure the chart correctly reflects that you pay a price. The chart currently just shows the same interest rates. It makes the assumption that you would be able to get an interest-only feature at the same price you would be able to -- I think it is important to say right off to the consumer, and you get to pay for that.

Then on the ARM example, I actually looked at this in terms of saying again, you can get a 5/1 ARM, and you can get the feature of having a 5/1 ARM with interest only, again with a pricing adjustment, and here is how the payments would compare.

Then finally, there is the payment option product, which would offer you all of these features, and that may be -- In other words, I don't think most lenders offer -- I guess a number do, but all of those within the payment option -- but I don't think that is clear that there actually would be a product that would offer all three of these options in terms of payments. So somehow that needs to be translated.

I also think it needs to be -- I know it is noted here, but in the option payment column the first payment is really for the first month. After that, it is a negative amortizing. So that if they continue to make that payment for the remaining 12 months -- it is in the footnote, but it is a little bit lost -- you know, you have now triggered negative amortization for the rest of the year. It somehow needs to be highlighted, I think, pretty highly.

I agree with the comment that Bruce made that it should be 100,000 so it can be easily translatable. I also agree with the comment that the escrow needs to be factored in here so borrowers are really comparing apples to apples, and I think that is an important thing as we go forward. Thanks.

MR. EGGERT: Before I give Alan the last word, I just want to note that we are in a very different market than we were a year ago. The headline of the U.S. News -- or USA Today says that this past year we have had a drop of housing prices of 2.5 percent, which is the largest drop since 1969 since they started tracking.

So we are not going to see the great appreciation we have seen lately, and brokers who have sold these products saying don't worry about it, your housing price will go up, now are going to see all of those borrowers facing decreasing housing prices as their loan payments go up, and that could cause grave problems for especially my part of the country, California. Alan?

MR. WHITE: I just want to make a couple of comments in response. First of all, I am heartened to see there's a lot of agreement that there is a consumer protection problem that the guidance doesn't address, because it is not really intended to address. It is really more of a safety-and-soundness guidance, and it obviously doesn't cover the entire market.

I completely agree that, either through Truth in Lending or FTC rules or in some other way, the consumer protection issue needs to be addressed as soon as possible.

These graduated payment mortgages with negative amortization are a dangerous product in the same way that an exploding Pinto is a dangerous product, and I think that regulation needs to take that into account.

I know Bruce does not make loans that he expects to fail or to result in foreclosure, but there are lenders in the market today, big lenders, who are making loans, knowing that 10 percent or more of them are going to result in foreclosure and losses of homes. They know that, and they have priced their product accordingly.

The consumers, on the other hand, do not know that. The other problem is that consumers suffer what behavioral economists call risk myopia, a bias by which, no matter how much you tell them what the true risks are and equip them with actual information, they do not necessarily respond in a utility maximizing way to that information. They discount risks of future bad events. That's a known thing that marketers know.

The other comment that I wanted to make: Several people referred to my presentation as referring to bad actors or bad characters in the market, and that is the exact opposite of what I am trying to say.

The sale of these graduated payment loans -- It's not a problem of a few individual bad actors, and I brought an example, because an example is nice and concrete to look at. But if you go to Yahoo and type "Mortgage," you will immediately be directed to an ad for Lending Tree, a very large national Internet broker, and prominently featured on the top line it says $300,000 loan for $1,000 a month! Save up to $300 a month! That's all it says.

If you click through carefully and find out what they are talking about, they are talking about a so-called option ARM, a graduated payment loan with negative amortization.

Every advertisement I have seen for this product talks about the monthly payment and nothing else, and the monthly payment -- by that, I mean the Year One negatively amortizing payment. I have not seen a print or an Internet ad for this product which fairly and accurately discloses what it is and what the risks are, and even what will happen to the payments.

I don't think this is a problem of bad actors, and I certainly don't think that when 9 percent of the loans made in the first half of this year is this product. I just don't see how 9 percent of homeowners, that's a suitable product for them. So I don't think it is a problem of bad characters. I think this is a product that is out of control, very dangerous, and we are going to see some problems in the future as a result of it.

I think doing some disclosure and some consumer protection as soon as possible will be very important. I think even the guidance may have some impact on this volume growth, hopefully. But I think some thought also needs to be given to thinking about these products as being inherently dangerous, and maybe looking at some further regulation other than just disclosure regulations.

MR. EGGERT: I would like to thank you all for that very interesting discussion. I think we have a break now. Is that correct?

VICE CHAIR SODEIKA: Yes, we do. thank you, everyone. We will take a 10-minute break and come back sharp at eleven to discuss affordable housing.

(Whereupon, the foregoing matter went off the record at 10:49 a.m. and went back on the record at 11:09 a.m.)

VICE CHAIR SODEIKA: Okay, we are going to get back together and get started. Just before we start our topic on affordable housing, Governor Bies would like to make a statement.

GOVERNOR BIES: Well, as always, I just consulted with our attorneys, and I want to clarify my earlier comment, and I want to read to you from the text of what we just released. This was the first sentence in the preamble and the second sentence in the actual reg text. What we are talking about is this, and this is what I take as the main principle we are trying to get across here, is it applies to closed-end residential mortgage loan products that allow borrowers to defer repayment of principle and sometimes interest.

I include in that generic products, whether there is an explicit option to the customer, as we have in Option ARM products, or an embedded option that may be financial sophistication needs.

They tell me there is confusion out there. They have heard from some of the folks. We will go through a process to clarify exactly what the terms are, what the scope is of the guidance that we went out and worked with the other agencies to get consistent agreement on what it is. But I think what we really want to focus on is the whole issue around payment shock and working with customers to make clear what it is and, for banks who are doing the underwriting, that they look from a safety-and-soundness at the higher monthly payments that are embedded in these loans when they do the underwriting. That is the principle we were trying to get through in this guidance, and I take back my earlier comments, and apparently we do need to make some technical corrections to make this more principle-based as opposed to detail-based. But I think we feel pretty strongly that that is what we were trying to accomplish in this guidance.

VICE CHAIR SODEIKA: Thank you, Governor Bies.

Our third topic for discussion today then is affordable housing. Increasing housing affordability has been a key element of many community reinvestment strategies to revitalize distressed communities and to increase the financial stability of resident households, particularly those with low- and moderate-incomes.

Financial institutions play a critical role in the provision of mortgage credit and in the financing of affordable housing development, while the Federal Reserve's activities make an important contribution to affordable housing in several ways. However, the landscape for affordable housing has become increasingly complex, and affordability has become increasingly unattainable in many markets.

So yesterday members of the Community Affairs and Housing Committee discussed various aspects of challenges in creating and sustaining affordable housing. With that, I would like to ask Mary Jane Seebach, the chair of that committee, to begin our discussion.

MS. SEEBACH: Thank you. “Oxymoron” is defined in Webster's as a combination of contradictory or incongruous words. Our topic for the next hour should probably be added to the next dictionary as a prime example.

The current lack of affordable housing is one of the most important issues facing this country. How we as a country choose to respond to this issue will greatly influence the economic sustainability of many markets, both urban and rural.

In the past few years, many homeowners have benefitted by accessing the equity in their increasingly more valuable homes. This increase in home values, however, has only exacerbated an already too obvious distinction between those that have a home and those who can only wish they had a home.

For many Americans, affordable housing means traveling great distances between their homes and their works. Rising fuel costs, however, are quickly making even that option less attractive. While many people talk about an affordable housing crisis, there seems to be little leadership and few incentives and opportunities to address the problem.

Yesterday we heard from one of our Council members on the rebuilding of housing in the Mississippi Gulf region, clearly a tremendous opportunity to proactively incorporate affordable housing options in a general revitalization plan. Yet this opportunity is being largely overlooked.

The dramatic appreciation of property values in the Gulf region highlights that, without such forward looking planning, many lower-income families will be completely left without alternatives and forced from the area.

Our goal today as a Council is to discuss the current issues affecting the availability of affordable housing and to offer broad policy recommendations that may be helpful to the Board in its various roles.

The Consumer Advisory Council benefits greatly from the participation of its many members who are actively involved in working with their communities to develop and preserve affordable housing. These members are very cognizant of the impact on their local economies when housing is not affordable.

We are also fortunate to have members from the financial institutions who are actively involved in partnering with local groups to address the shortages. Still others of us are not directly involved in affordable housing initiatives, but clearly understand the implications of a market where home ownership is increasingly unobtainable.

In my home state, California, where the median price has recently come down to $455,000, it is inconceivable how individuals in service related as well as critical support functions can afford to buy a home.

For our discussion today, we have opted against establishing a limited definition of affordable housing, except to say that when we talk about the need for a comprehensive policy addressing affordable housing, we mean the availability of quality housing.

Therefore, our discussion will include recommendations that will impact not only housing for working families but also housing for the chronically homeless. It includes the availability of decent rental and ownership opportunities.

Our discussion today will look first at the appropriate role for arguably the most important stakeholders in developing a comprehensive housing policy, the government at the federal, state and local levels, the government sponsored enterprises, and financial institutions.

While we will identify issues with how these various participants are currently fulfilling their roles, it is our intent to identify solid opportunities for improvement and for creating better policy solutions. Our discussion will then focus on current incentives as well as what additional incentives are needed to increase the supply of affordable housing.

I would like to start off by inviting Hattie Dorsey to start our discussion by focusing on the appropriate role of the federal government in these endeavors.

MS. DORSEY: Thank you, Mary Jane. I want to say that, for the last 20 years, I have worked as a major part of my career in the promoting and production of affordable housing to make certain that it is on the agenda, especially in the region that I come from which is the Atlanta Metro region.

I am pleased very much that the CAC is now discussing this subject, ironically, as I depart from the CAC and also as I retire from my organization where I have headed up the Atlanta Neighborhood Development Partnership for the last 15 to 16 years.

First and foremost, I believe that we must view affordable housing as an economic engine. It is, in fact, and has been the economic driven basis for our economy for the last several years, and now may contribute to the economic slide we are now inevitably facing.

The problem we face is that there is no such thing as affordable housing in this country. There is no way that we can do affordable housing without the kind of subsidies and buy-downs that is essential to those of us in the not-for-profit sector to deliver.

Strategy that exists today: We operate under 1949 legislation which has some of the basic tenets never, ever implemented. The act has not been fully implemented since 1949. The closest we have seen to come in this country, and some of us in the field say this with some chagrin, is that our national housing policy is a prison system, where we see the state legislators lining up to vie for prison beds in their country.

Let me give you some of the basic principles, and we talk about principles, as we had talked in our last conversation. In December of 2000, the Congress of the United States, the various committees and other organizations, set up what we call the Millennium Housing Task

Force, and that task force set up for three very basic principles: The importance of housing, particularly affordable housing, which includes housing for the elderly, to the infrastructure of the United States.

The second one was the various possible methods for increasing the role of the private sector in providing affordable housing in the United States, including the effectiveness and efficiency of such methods; and, three, whether the existing programs of the Department of Housing and Urban Development work in conjunction with one another to provide better housing opportunities for families, neighborhoods, and communities, and how such programs be improved with respect to such purpose.

This was the Millennium Housing Commission's basic purpose. Five public hearings were heard. Numerous focus groups and commissioned papers appeared. A 126-page report was developed and submitted to Congress in May of 2002. Out of the 12 recommendations provided by the report, none of them have been ratified by Congress.

It seems as if the Millennium Housing Commission activity was no more than an exercise in futility. What recommendations, if any, are the policy that policymakers don't have the willingness or courage to enact the recommendations that takes care of our broad population.

Let's go back to 1949. When we look at 1949, there was a very basic principle there. I believe Senator Robert Taft, a Republican, said that the government must see that every family has a minimum standard of decent shelter. The hand-me-down theory works, but it works to provide indecent housing for those who get it on the last hand-down. We cannot pour in all the assistance from the top, and that is all private industry can do or be expected to do. I think we also must attack the problem from the bottom. Fifty-five years later, we have yet to enact the basic tenets of the 1949 legislation.

Americans who work hard, whatever their profession, should be able to find decent, safe, affordable housing. For many working people, however, this basic principle has not and will not be realized.

We have several problems that influence that. We have no minimum wage law that has been enacted for the last -- what? -- 18 years. So we have a stagnant economy for the people who we expect to serve us. We also do not see any future raise in the stagnant wages that we have to live with as we face an increase in housing products.

To this end, we believe that the federal government should launch a fresh, new approach that seeks to leverage national, state and local resources which too often do not have the resources to do this particular work in order to build strong communities and increase the supply of safe, affordable housing for all Americans.

So I say to you that, as we discuss this particular subject let's think about the impact that our earlier conversations have had on the working poor, the very low- to moderate-income populations, and the people who are disadvantaged in our society. Thank you.

MS. SEEBACH: Thanks, Hattie. Don?

MR. CURRIE: I just want to follow up on some of Hattie's comments and kind of tie in what we were talking about this morning in terms of subprime lending.

I completely concur that I think our federal housing policy is -- I'm not exactly sure what our federal housing policy is, but whatever it is, is basically not leading the way into providing the opportunity for affordable housing to develop.

Much of our policy is basically developed around a more intervention kind of a strategy versus a development strategy. In affordable housing as a single family, nonprofit developing housing for home ownership, we have to take a much bigger picture view. We have to take a much longer term view of how to bring affordability to the marketplace, which includes raw land, includes development costs, includes financing projects, includes salability of the projects, and ultimately includes what type of products are going to be available in the marketplace for people to buy affordable housing as it is basically put onto the ground.

That's where I think the world of the banks, I think the world of the GSEs is a critically important role. While I was working with two of the GSEs, and I know HUD sets their affordable housing goals and how much affordable housing product that they basically need to purchase, one of the things that was striking to me was their admission that the product that they were basically going out and purchasing was really not product that they were -- new product that was being generated and being put on the ground.

One of the things both of the GSEs said was, in order to meet their goals, they basically go to financial institutions. They buy portfolio at a premium, affordable housing that has already been made available on the marketplace. They basically buy that at a premium, bring that into their portfolio in order to meet their affordable housing goals.

So rather than spurring additional affordable housing development through the creation of new products, new leverage mechanisms, reducing risks, basically they are taking product that has already been made available in the marketplace, bringing it into their own portfolios and getting some additional credit, I would imagine, for going ahead and doing that.

I think the place that the local banking institutions play the most prominent role in affordable housing is helping affordable housing developers, or developers in general, to develop new product opportunities and new market niches in which they can control for their risks, they can basically control for the type of project that is being developed, they can control basically the servicing of the product, and they can document and demonstrate payment capability. They can demonstrate and document risk profiles, and they can keep those products in their portfolio for a period of time and are at some point in time then able to, for all practical purposes, make those products available in either a bigger marketplace or place those products into the secondary market.

I think what is lacking is a connection between the local banking institutions, the secondary market providers, the MI companies and insurance providers that basically provide for seasoning of those type of products that can be made available safely, that can be made available soundly, that can be made available affordably and can essentially build new marketplaces.

I think that the thing of the subprime lending -- I think that is an excellent example kind of in the inverse of what has basically happened. The space was created in the marketplace. Subprime lenders basically stepped into that space. They have created opportunities in that market space, but I think a lot of the abuses that we talked about this morning are an indication that maybe that marketplace is not the ideal place for affordable housing to be demonstrated.

I think the place for it to be demonstrated is in the regulated environment where institutions can be careful about what they do, can be accountable for what they do, but at the same time can test what they do, prove what they do, and build new markets that are going to be more efficient and are going to be more stable over the long term.

MS. SEEBACH: Thanks, Don. We heard shocking data, and I have forgotten the number, but year over year the reduction in FHA products in the market has dropped from double digits down to single digits as amount of total production. I mean, as Don indicated, there is a lack of new product and new opportunities coming out from this market, and it needs to be addressed.

Hold on one second. We got Stella.

MS. ADAMS: Thank you, Mary Jane. I want to talk about affordable housing from a rural perspective, because in rural markets you can't get to scale, and a lot of the products and innovations require lots of units and lots of -- In order to make it affordable for developers to develop, you have to have a certain level of scale, and in very rural communities you can't get that.

So what has developed is that to build five houses in a rural county is not cost effective for a builder. So they don't go there, and the alternative affordable housing market is manufactured housing.

In North Carolina, one out of every five homes purchased is a manufactured home. Sixty percent of the affordable housing stock in North Carolina is manufactured housing. Yet only 30 percent of that stock is considered real estate and is treated as real estate. The rest of it is a chattel loan.

So there is a need to step in and create a marketplace, create the environment that will allow for these homes that people are purchasing to be treated as real estate and to have some opportunity for appreciation. It will never appreciate as much as a home, but I can't necessarily say that, because there are some trailers, what we would call trailers at home, in California that are selling for $150,000. These wouldn't be worth $10,000 on the farm back home.

So there is an opportunity for appreciation where you have market conditions, but we need to create a stable market, a stable secondary market for these products, stable environment for turning these into real estate loans, creating a market for resale that doesn't exist. You are talking about taking off the table in rural communities an affordable option if you don't create that possibility.

Also, we need to -- The GSEs are not doing a good enough job of reaching out. Again, it is because of scale. A lot of small community banks in rural communities cannot sell to the GSEs because they don't have enough volume, and there's got to be a way to encourage the GSEs not to abandon these community banks that are willing to be innovative and willing to take the risk to create affordable housing options in their community, if they had a way of selling to the secondary market.

So rather than buying big, fat portfolios, they ought to be encouraged to do outreach to small community banks that are serving rural communities, and they should be encouraged to have a rural initiative and to look at innovative products and services in that way.

MS. SEEBACH: Thank you. Faith.

MS. SCHWARTZ: Following up on Stella, we had a lively discussion yesterday on this affordable housing issue, and in fact, one of the main common themes was it needs a subsidy. It felt like a lightbulb coming on. You've got this market segment that is manufactured housing that is not operating too effectively because of title issues in real property versus personal property loans. It is a repossession versus a foreclosure if something goes wrong, and lenders don't have a very liquid market.

It is driven by state laws, and I think it seems to me that the GSEs who have great pressure, and as a former GSE employee that is still the way they were back then and are today, to work with affordable housing goals and issues, and it seems that part of the solution in a nonsubsidized way is just making that a healthier market for clear title and ability to make these real estate loans across the country.

I'm not sure it is a big subsidization, if you've got the cost of housing cut in half and a very big need that's been shown. So I just think it is a component of a solution in a broader strategy.

MS. SEEBACH: Alan.

MR. WHITE: Yes. I'm sorry. I'm fascinated by the manufactured housing discussion, but I work in North Philadelphia, and I don't encounter that issue too often. But I do want to echo Don's comments about FHA and the government-sponsored enterprises.

I don't know much about rental housing either. That is, obviously, an important part of affordable housing, but for home ownership for low-income folks, 25 years ago my clients, almost exclusively African Americans, were buying houses for between $10,000 and $50,000 with FHA and VA insured loans made either by local banks or thrifts, Philadelphia Savings Society, for example, or just mortgage bankers, and they were all selling the product to Fannie and Freddie and occasionally some of the state pension funds.

That was the structure of the mortgages I saw that were occasionally going into foreclosure at much lower rates than we see now, obviously. What happened is that in the 1990s -- and Philadelphia is very unique as an East Coast city because the property values have not appreciated the way they have in the rest of the country, although we are catching up now.

What happened in the 1990s is that, somehow or other, all those FHA loans that were made essentially at market rates with a little extra for the premium, but that is a very small marginal cost, relatively speaking -- A lot of those loans in the 1990s got replaced by subprime loan product, both through refinancing -- and that was always a sad story. Somebody who had owned a house for 20 or 25 years with an FHA loan almost paid off, and then they triple their debt overnight and lose their house, but also the purchasing process, the same real estate brokers who used to have relationships with the local banks to make those FHA loans held by GSEs -- Instead, the path of least resistance for the real estate brokers was to send clients to subprime loan brokers, and they developed relationships many times because of their economic incentives to do that for the brokers and the agents, and it is a real agency problem in this market because a lot of these transactions don't necessarily make sense for the ultimate holder or investor, but that doesn't really matter in terms of the incentives to the people doing the transactions.

So kind of the good product for affordable lending got pushed out by the bad product, and that is kind of my experience of what's happened. I don't know exactly what needs to happen with FHA and with the GSE’s role in creating these affordable and reasonably priced loan products, but I suspect that when the current expansion in home prices contracts a little bit, which is bound to happen sooner or later, it might be an opportunity to step in at that point. But I think FHA and the GSEs need to kind of rethink the way they market and the way they compete so that we don't have the bad financing products driving out the good financing products.

I think that needs to be part of the strategy of regulated financial institutions and part of their CRA obligations, and it is also a Fair Lending issue, to my mind.

Part of why you see disparities in the HMDA data, we are told, is that, you know, basically, black homeowners go to a certain kind of lender and white homeowners go to another kind of lender, and that suggests that the good lenders making loans to white people have stopped making loans in African American neighborhoods or at least are not making their fair share.

I think some of that Fair Lending enforcement may be somewhat helpful on the affordability issue.

MS. SEEBACH: Thank you. Marva.

MS. WILLIAMS: I would like to thank Mary Jane for advocating the discussion of this topic this morning. It is a very broad topic, but I also appreciate the ability to talk about it in a holistic manner. So thank you, Mary Jane, and we are going to miss you.

As you all know, affordable homes affects many different people. It affects the working poor. It affects middle-income people living in very high cost communities, but it also affects people who are in dire need that I really want to talk about, which is the homeless.

I volunteered with an agency in Chicago for over 10 years now, Debra's Place, that works with homeless women, and I can tell you that during that time we have seen a significant increase in the need for shelter as well as services for homeless people, and much of this has been exacerbated by a federal policy.

I think many of us have said today that there are no federal policies around affordable housing, but there is a federal policy that deals with homelessness. It was enacted in 2001, and it is called the Ten-Year Plan to End Chronic Homelessness. The chronic homeless are defined as people who have experienced homelessness continuously for at least a year, and there is also an emphasis on permanent housing as the solution to chronic homelessness.

While this is a very laudable goal, it misses a number of different populations and communities that are also experiencing homelessness. For instance, it does not include people who are doubling up and tripling up in apartments and homes as well as in motels, as described by Barbara Ehrenreich in her book *Nickled and Dimed*, and it also doesn't include people who are victims of domestic violence, and increasingly, what we are seeing are teenagers, youth, who are also experiencing homelessness.

As a result of this, over 30 percent of the people who come to shelters across the country are turned away, because there are not adequate facilities to serve them.

So three things need to happen. There needs to be an expanded definition. We need to look beyond people who are chronically homeless. In addition to that, I think it is also important to look at ways to prevent homelessness, and this can include so many different programs from foreclosure prevention to the development of affordable rental housing and other kinds of programs. Then last, I think it is very important to increase the support for transitional centers and for shelters as well as facilities that provide supportive services.

MS. SEEBACH: Thank you. Tony.

MR. BROWN: I would like to speak to the issue from an urban perspective as a developer. I think the primary issue we have is one -- We have an environmental issue. Our organization is a nonprofit developer, well capitalized with nearly half a billion dollars of developing in our pipeline in a city that has lost more people in the past decade as a metropolitan area only second to Detroit, and in the areas in which we are developing have a home-ownership rate of only 22 percent.

So there are three points I would like to make on the issue of affordable housing.

One is we have to increase the availability of public subsidy in order to develop product that is affordable to low- and moderate-income people. I think the administration missed a tremendous opportunity in how they wrote out the "Strengthening of America's Community

Initiative," the SAC initiative. By most people, it was seen not as a vision for increasing home ownership or reducing regulatory burden. I think it was largely seen as a way to cut money out of community development block grant funding to our nation's cities.

So we have to address the source and funding to buy down the cost of new housing for our residents.

The second point I will make: Because community development block grant funding is so important to affordable housing developers that we need to relook at the regulation and reassess the regulations regarding CDBG funding.

Issues regarding relocation assistance, the Davis-Bacon applicability -- I think those are important things, but how they are applied or at least how they are interpreted at the local level has given us cause for concern.

For example, in working with our local community we created a vision for workforce housing. We went on and basically purchased six, seven blocks of housing, to find out later when it was time to now work with the city to try to close the financial gaps that the city's interpretation of relocation assistance meant that we had to go back to properties we acquired a year ago, and we had to get the seller to attest that they got a fair market price for what we purchased, and then if they had rental tenants, we had to go back a year to when that previous owner owned the property to offer those tenants relocation assistance.

So just having to go back where we had in essence bought $4 million worth of speculative property -- and this is an urban area, and it represented about 50 parcels -- was just too much of a regulatory burden to do.

So we have to look at regulations in this new environment.

Then a third thing I would mention is sort of the product offering. I know we just talked about nontraditional mortgages, but particularly in urban areas and the fact that banks are underwriting to secondary market guidelines, I think that in communities like Cincinnati where you have a great housing stock and that the houses are 100 years old that our borrowers cannot get an acquisition and rehab product where the cost of rehab could be twice as much as the purchase price -- one, because there is no secondary market that would allow the bank to originate it, and then secondly, banks are afraid to undergo the construction risks or the rehab risks when it exceeds the purchase price -- and then in an area where there is a concentrated urban renewal effort that those first houses will not necessarily meet appraisal guidelines, and that that also ends up becoming an impediment.

So those would be the three points that I would address: Increasing subsidy for development; addressing regulations regarding some of those subsidy fundings, particularly community development block grant funding; and then creating an environment where Fannie and Freddie will allow for acquisition rehab in particularly our urban areas where rehab cost exceeds acquisition.

MS. SEEBACH: Thanks, Tony. Ed?

MR. SIVAK: Thanks, Mary Jane. I would just like to pick up on some of the comments about rural areas and scale. Stella did a good job of kind of outlining some of the things around manufactured housing.

There is a best practice for that in New Hampshire. So if there is any interest in looking at that further, New Hampshire has done a good job, both through coops and through connecting manufactured housing to the land. That was kind of the key thing that they did. It wasn't necessarily the unit that appreciated. It was the land that appreciated.

Talking about the issue of scale, there is also a need for affordable rental property in rural areas. In urban areas you can get low-income housing tax credits to build a 100, 200, 300 unit, multifamily complex, and you can syndicate those credits and use them to build these units, and there is a market for those, and they can be sold.

In rural areas, you obviously don't need a 200-unit, multifamily complex. We are talking about 25 to 50 units, typically located in the county seat where the jobs are located.

Similar to Stella's problem where you have community banks that can't have a product that they can sell in the secondary market, in the same way you can't syndicate a single multifamily project for 50 units. It's just not -- It's too costly, and it is also hard to get enough of them bundled to move it on to the next market from one developer.

So there is a potential opportunity with the GSEs to look at how do we use the resources of the GSEs to address these multifamily issues in rural areas against replacing stock, making stock available and affordable, by creating a market for these credits, again so that those can be built.

My second point that I would like to also talk about on the issue of affordability is things that are happening on the Gulf Coast. Mississippi is a rural state, and in a lot of ways we have never really had to deal with a lot of the affordability challenges that a California or New York City has had to deal with. However, since the storm, affordability has gotten put on the map.

It is interesting, because part of it is appreciation. We see in low-income areas on the Gulf Coast, and this is in Harrison County which is where Biloxi is, homes have gone -- low-income neighborhoods have gone from $53,400 to $111,000. That's a 93 percent increase. In moderate-income areas there has been 39 percent increase, and in high-income areas a 28 percent increase. I just used real estate comps. It is not selective. I don't want to say this was scientific, but I talked to a realtor for that.

The other challenge is that the insurance costs skyrocketed. So a policy that you could get before on a $100,000 house with $40,000 of contents may have been $1,000 annually. Now it is $2,000. That is just for wind. Then you have to buy a flood insurance policy. Then you have to buy a hazard insurance policy, and this is what is required to get a mortgage.

So I don't have an answer to this insurance question, but I do feel like it is something that needs to be raised at the national level. I also know that the Federal Reserve Board doesn't necessarily have oversight of the insurance industry, but again this is an issue that people are facing and it is an issue that affects mortgage markets, and it is something that we need the resources and the brain power of everyone in the country thinking about; because it needs to be figured out. Thanks.

MS. SEEBACH: Thank you, Ed. Carolyn.

MS. CARTER: I would like to follow up on what Stella and Faith and Ed have said about manufactured housing. Manufactured housing is a major form of affordable housing, especially in rural areas, but it has been under the radar. It hasn't really been considered by policymakers as an important sector of affordable housing.

As a legal services attorney in Gettysburg, Pennsylvania for many years, I had lots of clients who lived in manufactured homes. Most of them lived in manufactured homes that were placed in parks on rented land, and my point of view from observing those cases was that it was a bad form of affordable housing for most of those clients.

There were often problems with the quality of construction of the home, and then placing the home on rented land is like building a house on quicksand; because the land can be sold out from under the home, and then the owner of the home basically loses the value of that asset. In fact, in Gettysburg, there is now a shopping center, and 100 homes -- people were thrown on the housing market, and it was a big mess.

My view is that the quality of manufactured home construction is being addressed. I am not going to claim that those problems are solved, but I believe it is being addressed with stiffer HUD standards and also some self-improvement on the part of the industry; and I have been in manufactured homes recently that were just beautiful, just as nice as any home you would ever look at.

Still -- and so I am convinced that, if there is good construction and if it is placed on land that the resident controls, a manufactured home can be a very good form of affordable housing, and I have read a study recently -- I wish I could cite it -- that showed that manufactured homes placed on land controlled by a resident, by the owner, did increase in value, not as much as stick-built housing, but it did increase. Manufactured homes placed on rented land were in no way an asset, no way an asset-building exercise.

A growing form of resident control of the land is through co-ops, and this is particularly important for low-income residents in existing manufactured housing parks. In many parts of the United States, those parks are vulnerable to development. They are being turned into condos, shopping centers, et cetera, et cetera, and when that happens, hundreds or thousands of low-income residents lose their asset, their main asset, and are thrown on the affordable housing market.

The New Hampshire model that Ed mentioned is a very -- involved the residents having an opportunity to then buy the land collectively on which their homes sit, either in a condo form of ownership or a co-op form of ownership.

One big problem, though, is that, as I understand it, lenders and Fannie and Freddie still do not treat those as eligible for real estate loans. They are still -- When the home is on land that is not owned in fee simple, that is owned in a cooperative or a condo type arrangement, it is my understanding that most lenders would still only give personal property chattel mortgage lending for that home.

What I would like to encourage the Fed to do, and the other federal regulators and also Fannie and Freddie, is to take a close look at what is going on in this market.

First, are lenders and Freddie and Fannie treating these loans as real estate loans for lending purposes when the home is on land that is controlled, in one way or another, by the owner of the home?

What can the federal regulators and Fannie and Freddie do to encourage resident ownership of land, and some of that involves intervening with park owners so that residents know before the park is sold out from under them that it is going to be sold, so that they have the opportunity to purchase it collectively.

What are the barriers to treating manufactured housing lending as real estate lending? Some of it is state law, but some, I think, is banking policy or policies on the part of Fannie and Freddie.

A final question is: What are banking policies and Fannie and Freddie policies regarding sale of existing manufactured homes? If you own a home and you've gotten a real estate loan, your financing, but you can't ever sell it. There is no market for selling. There is no financing for selling it. It is not what we really think of as an asset.

It is my understanding that Fannie and possibly Freddie won't buy -- won't accept loans for existing manufactured homes, and I consider that a serious problem, because it makes -- it really undermines the value of the home as an asset.

I also suggest that, as banking regulators and Fannie and Freddie look at -- examine these questions, they ask what can be done as part of CRA exams to promote these goals?

MS. SEEBACH: Thank you. We are coming down to the end of our time. I have four more folks. So I have Mark, Hattie, Stella, and Sarah. Mark?

MR. METZ: Three points. First, Tony made this already, but I just would reiterate it. When I work with developing affordable housing, we have found that subsidies for down payment assistance is really a key factor for that.

The second point: We have found -- and this is not really a Fed issue, but we have run into difficulties with local zoning ordinances and making it difficult to site and locate properties where people want to live, and we have been running into local problems with that.

Then the third point: We haven't gotten into it that much, but a lot of the discussion, I think, on these issues sometimes turns out to be a tug of war between public and private sector, and I think it really doesn't have to be that way.

I think there are some very successful partnerships where nonprofits have developed with -- have partnered with successful developers and banks to create very good projects that have worked, I think, for everyone. I would just encourage the Fed to consider those and incent those kinds of things.

MS. SEEBACH: Thanks, Mark. Hattie?

MS. DORSEY: First of all, I want to say that some of us sit on this committee representing the voices in our communities, people who won't ever have the opportunity to talk to you. I would like to say in their behalf that affordable housing is an economic issue.

I think sometimes you might begin to think how do I influence some of the public policies that need to take place in order to make affordability happen. I think often times that, when we talk about affordable housing, people's eyes, and especially our legislators' eyes, cloud over, because they think about the very poor or the group that they can't really figure out how to do something for them. But when it begins to hit home is when your daughter who just recently graduated from a college with that beautiful piece of paper that gives them that degree to enter into a big economic environment, that they can't afford to live close to where their jobs are, that they can't afford to live close to where their parents live, or they can't afford to live in decent and quality housing. That is when that begins to hit home.

I agree that we do have some problems in our society, and it particularly begins with the federal government, our national government. Tony spoke to the fact that we have tax credits, but let's look at tax credits. Tax credits do not address the need. Tax credits are based on the median income of an area, and sometimes that translates to market rate in some communities. So the low- to moderate-income that lives in that community can't afford to live in a tax credit unit.

The home dollars, the CDBG dollars, are not efficiently used at the local level. Those are the only dollars right now that buy down and subsidize affordable housing.

Very few state and local governments rise to the challenge in order to meet the needs of affordable housing, and some, though, however, have gotten a little smarter and started doing tax allocation districts, started making certain that the for-profit developers include at least a minimum in their development process. But we have lost a very important piece, which is HOPE VI. HOPE VI did provide for a mix of income for lower- to moderate- to middle-income people. So that has been eliminated from the national agenda.

So I think that we have got to begin to look at how, in fact, we are going to come up with other strategies. I would like to ask the Board to really communicate that housing is an economic issue, an economic issue that, if not paid attention to, will cause and contribute to the demise of the economy that we now enjoy.

So those are some of the things that I would like to say, that it is a difficult subject. It has many parts, many arms and legs. Those of us in the not-for-profit community that try to provide affordable housing can't do it by ourselves. We can't meet the demand. We can't even begin to continue our operations without the intervention that needs to be a part of any strategy. Thank you.

MS. SEEBACH: Thank you. Stella.

MS. ADAMS: Fortunately, Mark covered a couple of things that I wanted to cover. So I don't have to get those in.

One of the things as a solution I want to offer is that HMDA and CRA had as a goal figuring out where there were underserved markets and where public and private partnerships could come into effect to create affordable housing and create market opportunities where they were not met.

I want to encourage the Fed to encourage its examiners when they are looking at CRA to look at the consolidated planning process for CDBG and home where the state for rural areas and the MSAs for cities like Atlanta and Philadelphia, analyze the housing needs and the affordability shortages in their community on a five-year basis and develop a five-year plan to try to attack those needs and see what role financial institutions are playing in meeting those needs that are articulated in those public policy plans.

Encourage lenders to engage in public/private partnerships. It may be that pooling assets in conjunction with city dollars or county dollars or state dollars, that participating in loan pools, participating in equity subsidies with government as your partner is a less riskier business than trying to take that on as an institution.

These are ways that we can increase affordability, the affordable housing stock, because this is something that local communities are focused on doing. So they are natural partners, and it is a shame if we examine a lender in an MSA and we don't see that lender participating in the programs and products that the city it serves are participating in.

So encourage the public/private partnerships, which is one of the original goals of HMDA and CRA, and encourage participation by financial institutions in not only carrying out programs but in creating the assessment for community needs locally. Thank you.

MS. SEEBACH: Thank you. Sarah with the last word.

MS. LUDWIG: So I want to thank Mary Jane also for putting this subject on the agenda. Broad as it is, it is a little bit hard for me to kind of focus what I think is going to be the most important, relevant information for the Governors.

I think that, you know, as you framed it at the beginning, it is not an issue just about home ownership, but also about the rental market and affordability there.

I come from New York. It is a city dominated by renters of all incomes. The 8 million people who live there – two-thirds of the population rent. We have seen that there are some lending practices that have really significant community impacts, particularly on rental market in neighborhoods that are undergoing gentrification.

So in New York we have seen a spate of evictions of low-income renters who are in buildings in neighborhoods where property values are fast increasing or perceived to be soon increasing, and literally thousands of people losing their rental apartments in buildings where the mortgages are over-leveraged.

What I mean by that is that the mortgages are being made for amounts that far and away exceed what the income is on the building-based on the rent coming in. So you see that mismatch where the landlord is getting a mortgage where the mortgage payments are not sustained by any stretch of the imagination by the rent that is coming in.

As a result, and I think as part of the design, the landlords have a sort of incentive to get rid of the tenants so that they can bring in higher paying tenants in these neighborhoods where they are getting higher-paying -- or higher-income individuals, and it has become a very serious problem.

I also just want to tie in the question of affordable housing to our conversation this morning around nontraditional mortgages. What we are seeing also in New York, but I have been hearing about this around the country to some degree, is that families -- I'll give you some real life examples.

Families that have household incomes of $30,000-$40,000 are getting principal-deferred mortgages for $500,000 and, you know, my colleagues who live in Rochester and other parts of the states say, $500,000, you get a mortgage -- you get a mansion. You get a mansion in Rochester. In New York City what you get for $500,000 is maybe a little house, possibly a two-bedroom apartment in some places of the city.

You know, people are getting into these mortgages and you say, what were you possibly thinking. What they say is they are able. This is a new trend. This is the new spate of foreclosures that we are getting, people who make $40,000 and getting $400,000-$500,000 mortgages. They are saying, I can afford it, it's no problem; and they don't understand they are paying only interest.

What's happening is they are getting into these homes that are also vastly over-appraised, and it is having this sort of neighborhood impact, because as you have a really high concentration of over-appraisals in a community where, by the way, this is trailing a pattern of foreclosures in the community, it sort of jacks up the prevailing purchase prices of homes in the neighborhood.

So you know, all of this comes around to me to sort of underscoring the need for suitability standards. I was thinking about that this morning when we were talking about nontraditional mortgages. It seems really paramount.

I think there is a really important role the Fed can play in its research arm in looking at the HMDA data, not just -- I'm changing subjects here -- not just in the sort of pricing information, which has, you know, I think, really captured a lot of our focus for good reason, but also to look at the distribution and availability of prime loans, conventional loans in neighborhoods or in areas where subprime lending and these exotic mortgages tend to be concentrated, certainly where the foreclosures are concentrated.

When we do research at our organization looking at some of the country's and the world's largest lenders that have, you know, great amount of assets and sometimes even a relatively large branch distribution in our city, we see that their presence in terms of their prime conventional loans is negligible in low-income communities and neighborhoods of color in New York. Again, this is a city of more than 8 million people.

I don't really see that inquiry being made at a systematic regulatory level as to this vacuum that we talked about in availability of prime, affordable, sound loans, but more sort of looking at the other side of it, which is the predominance of high costs for subprime or some of these other unsound loans.

Last, I would say the CRA is a very important tool. I think there needs to be a priority given for support of community land trusts and other sort of innovative, important ways that people have been able to develop and preserve affordable housing. Thank you.

MS. SEEBACH: Thank you very much.

VICE CHAIR SODEIKA: Thank you. Thank you very much. That was our final committee topic, and now it is time for our members forum.

As many of you know, during each of our meetings we have the privilege of hearing from one of our Council members on programs and initiatives at their organization. Today we are hearing from Anne Diedrick. She will provide us a brief presentation.

Anne is currently senior vice president and national community relations executive at JPMorgan Chase. In 1978 she joined Manufacturers Hanover Trust Company, a predecessor bank of JPMorgan Chase. Anne is responsible for philanthropy, sponsorships, public relations, community development services, and volunteers in the local market throughout the bank's domestic footprint.

National Community Relations also includes the Home-ownership Preservation Office and Financial Education and Research. Anne graduated from Manhattanville College in the Executive Program. This is very impressive. She also serves on the Board of Trustees of Community Services Society of New York and many other organizations, and we welcome you, Anne.

MS. DIEDRICK: Thank you. I have been privileged to be on this Council now for three years. This is my last meeting, and I have sat here and I have thought, well, it's time to maybe step up and do this presentation. So I hope it is interesting. It is something new to me.

This year I was asked to start a new organization in our bank called National Community Relations, and it really is a joint venture between Global Philanthropy and the Community Development Group that I have been in since its inception in the early 1990s.

The Community Development Group was really created to be an incubator to try new things, and then if we are successful with doing them, to move them on to the mainstream. So in the early 1990s, we were doing affordable mortgage products long before Freddie or Fannie did them, and we were given permission to hold them on our books.

You know, one by one, we were kind of making up our underwriting criteria as we went along. So we have done a lot of innovative things in the Community Development Group, including we had the first diversity supplier program that we then mainstreamed into purchasing.

We started doing faith-based lending. Today we do over a billion dollars in construction financing for affordable housing. So that group is only focused on low- and moderate-income communities throughout our branch banking network.

One of the interesting things here was that the Global Philanthropy was in the corporate part of the bank, and the Community Development Group was part of the retail bank, and they both were focused on building stronger communities, but they were kind of circling one another, particularly since the BankOne merger where we have all this geography that we didn't have before. So we thought we would get together and form something new.

So the organization is -- The bulk of it is community relations. I have a staff across 15 states. I was already involved with the Home Ownership Preservation Office. So I brought it over to this group. I thought there was a good synergy, and also Financial Education and Research.

Our mission is to serve the business, CRA and corporate citizenship goals of JPMorgan Chase in local communities throughout the United States. Our field offices facilitate local market philanthropy sponsorships, community development services, public relations, and employee volunteerism.

I don't run the foundation. I actually work for both the foundation and Community Development Group. The foundation gives us $60 million to work locally. So we are interested only in working locally.

Our measures of success: We want local decision making. I am on the JPMorgan historic side. We ran a foundation. It looked like a foundation. It really didn't ever talk to the businesses, and what we are trying to do is get that out of the ivory tower and put it out on the community where it can understand what is going on in the marketplace and make those decisions locally.

We also, obviously, want to engage our employees in local activities, and we want to make sure that what we are doing -- and this goes to the service test, Marva -- when we are doing services in the community, we want them to be responsive, innovative and measurable, and impactful.

Having staff throughout the marketplace will help us better with local market CRA leadership, and the staff is also charged with doing high-profile sponsorships. I know -- You may like parades, but I've said we are not doing parades. Doing big sponsorships that are meaningful and good public relations. But dark green states are the states where the staff is located, but then we also have JPMorgan offices in other states that we have a grant program in the light green states as well.

Live, learn, and thrive. That's kind of our mantra in my group, and it really is an easy way for us to think about our three areas of giving. The first one, Live, is we focus on issues of poverty, issues -- Within this area, we work on affordable housing, workforce development, neighborhood revitalization, after school programs, affordable child care, and other things that make for a healthier community, particularly totally focused on low- and moderate-income communities.

Learn: We are interested in access to higher education for those populations that have a more difficult time accessing higher education; particularly concerned about issues of Black and Hispanic males who have had a high dropout rate. We want to work on issues to help them. Financial education, obviously, is important to us, after school programs, and leadership development.

In arts and culture, we are working locally. So my group does not get involved with a grant that we would make to Lincoln Center. We are interested in community enrichment programs. We look to support emerging and under-represented artists, and we are looking for great branded sponsorships.

We have a Community Advisory Board, and it is 84 members, really big. We had a meeting actually on Tuesday in Chinatown, and then we took them out to see a lot of projects, and what I tell our members is you can help us not just by coming to our meetings a couple times a year, but by working with our community relations people every single day and on a real-time basis provided advice to them as they need it in the local community, and also providing advice to us on national community development issues and proposed legislation. They like to meet and exchange ideas with one another as well.

Just the states and the representation. It looks like a lot of people from New York. It's a lot of states, but almost half our deposits are still in New York. This is a really big, important market, and every borough of New York City is like the size of some of our states in terms of our presence.

This is the mission of the Home Ownership Preservation Office. It develops programs, policies, practices, and solutions aimed at home ownership by working with community leaders, housing advocates, homeownership counselors, investors and public officials and others.

These are the programs. We have a toll free help line for not-for-profit counselors only. This is not for customers. There is a different number for them to call. We are dealing with counselors here.

We have been providing loss mitigation workshops. We do local market seminars for at-risk borrowers, local foreclosure prevention initiatives, national initiatives. We have an REO program. I'll talk a little bit about each one.

This is the help line. It is dedicated for the not for profit community partners only. They are representing Chase customers or customers who are a big servicers. So we service a lot of other lenders' customers, too.

Loss mitigation training: What we found out was that a lot of counselors didn't know really how loss mitigation worked and what the different options are. So we have been going around the country and doing workshops for not-for-profit groups on the -- kind of the servicer-investor relationship and the different guidelines and standards, and we have done this training with over 1,100 community partners in the last two to three years.

Then we are working on an advanced program for them and also a session that we could do for smaller and more remote not-for-profit organizations.

Local foreclosure prevention initiatives: We are involved in them in several states. These are programs that are generally created by a local government or local government with some not-for-profit organizations, and then they ask the banks to participate. We are involved with the Pace in New York, which I think Sarah is very involved with.

The National Foreclosure Prevention Initiative: I think a lot of the lenders -- large lenders at this meeting are also involved. It is a partnership with Neighbor Works.

The Home Ownership Preservation Foundation: Fifteen lenders, Freddie, Fannie. It has established a national Hope hotline for borrowers to call directly who are in trouble.

There is -- We are working with the Ad Council, and there is going to be a large public awareness campaign that is going to kick off next April. The Ad Council has taken this on, which is terrific. We will get a lot of awareness out in the market.

We also run an REO program, and this is where from time to time we will donate properties or sell at a significant discount properties whose mission is to provide affordable housing to LMI borrowers. But the not-for-profit must demonstrate its financial ability to rehab the property. Most of these properties are distressed properties. This year we have given some properties away in Detroit and Chicago.

Finally, financial education: All of our businesses do have -- This goes to Deborah's question before. All of our businesses do have some types of financial education programs attached, and very often it is to attract and retain customers. It's a good practice.

We work with our businesses internally on their programs, and then we also looked at what was being provided a couple of years ago by the not-for-profit partners, and we were kind of disappointed by the quality of some of the programs that we saw being taught where they were asking us to sponsor these programs. We thought they weren't strong enough.

So we developed a branded curriculum. There's a lot of Money Smart stuff in here, because Money Smart said we could borrow from them, too. But we also took the Board books out, tried them out in groups of people and got ideas, and brought them back. So they have been worked on a lot. They are available today in English, Spanish, Chinese, Vietnamese, and Korean. The four modules, have instructor guidelines as well as basic banking, credit and debt management, understanding the mortgage process, and personal financial management.

We have also created really small take-one brochures that are available. A lot of times people do not have an hour or two hours to spend doing this. So we give them all the facts in a take-one brochure. We have also done a brochure on the earned income tax credit that is available in both English and Spanish.

Last year, we did 1,000 workshops and reached 22,000 people across our bank markets.

That's the story.

(Applause.)

VICE CHAIR SODEIKA: Thank you, Anne.

Okay. Now I would like to call upon our subcommittee chairs and vice chairs, if I can, to provide a brief report on our plans for future meetings, and I would start with the Community Affairs and Housing team. Stella Adams.

MS. ADAMS: Thank you. We are planning an exciting year next year. As you can see from our discussion earlier today, affordable housing is a broad topic and impacts different communities in different ways. So that will still be a major theme and issue for us in the coming year.

We are also anticipating that foreclosures will be a topic that we will want to address at some point next year. We are -- Committee members were concerned about the growing number of foreclosures in many parts of the country and the impact that some of the nontraditional mortgages are going to have on communities and so we will want to see -- address that at some point next year, probably in the June meeting, to kind of see what we can do about that.

Another issue that is impacting foreclosures is the issue of mortgage fraud, and we are going to look into what role mortgage fraud is playing in creating foreclosure environments and its impact on the creation and retention of affordable housing for communities.

We are also going to talk about mortgage reform. This is an issue that is really critical to Alan White, one of our members, and we are going to be looking at ways we can reform the mortgage market to improve access to credit and capital in a way that is healthy for the long term for the economy and for our communities and the people we serve.

Finally, we are going to look at Fair Lending and, hopefully, have a robust discussion about Fair Lending and making sure that equal access to credit is addressed.

We are not going to be satisfied with just noting the disparities, but we hope to talk about solutions and ways that we can decrease the disparities that exist, whether it is from intentional or non-intentional discrimination. Whatever the factors are that are impacting those disparities, we hope to bring to your attention some solutions that will close those gaps.

That is our proposed agenda for next year.

VICE CHAIR SODEIKA: Thank you, Stella. And Faith for the Depository and Delivery Systems Committee.

MS. ANDERSON: We had Mark Budnitz who is a professor, and he talked about the lack of uniformity in the payment systems, and so consumers are confused, if there is an error on their periodic statement or if there is an unauthorized use, on how many days do they have to trigger the error resolution process, whether they paid by check, credit card, debit card, looking at Regulation Z, Regulation E, or Check 21.

So we are going to focus on a few issues to see what we can do to make that easier to understand, whether it be by product type or error resolution or change in terms. So that will be one of our focus issues.

Then also the recently passed legislation of the Unlawful Internet Gambling Enforcement Act where it makes it unlawful for a financial transaction provider to be involved in any payment, whether it be by check, electronic fund transfer or credit card, to a person engaged in a unlawful Internet gambling.

The Fed and the Treasury will be drafting implementing regulations within the next nine months. So that will be very important to us.

Also we had a holdover topic from this last session, because we had so many other topics that we were discussing, about the use of fraudulent official checks and cashier's checks and how that relates to check clearing and hold practices, because what ends up happening is that our customer or member gives a check, not knowing that it is fraudulent, and then credit is given.

Then it turns out that there is a third party on the other end who initiated that check.

So these days, unlike the olden days where a cashier's check was as good as cash, it now makes you aware that, okay, we need to confirm that that is a legitimate check.

I'm sure we will also have information-security data and I didn't put it down here, but that is still a concern for us. But these were the topics for our March meeting.

VICE CHAIR SODEIKA: Thank you, Faith. Marva, will you report for the Compliance and Community Reinvestment Group?

MS. WILLIAMS: Sure. I am very excited about the topics that our committee will be exploring next year. Several of them are holdovers from this year.

The first is we had a very good discussion yesterday about prepaid cards, stored-value cards as well as payroll cards, and some concerns about the pricing of those cards as well as appropriate consumer protections.

We would like to continue our discussions and talk about best practices as well as the development of a typology to help us to identify model products.

In addition, we talked about how the Bank Secrecy Act is impeding efforts to reach under-served markets, that banks are developing policies regarding identification and other factors that are impeding the work that many of us are doing to reach, in particular, recent immigrants and to facilitate their partnership or entering into the financial mainstream.

So we will be continuing those discussions and talking to community development credit unions that have been successful in reaching that market.

We would also like to explore how the service test can be improved, how examiners currently use it to assess a bank's financial services, bank branches' products and services and so on.

Then last, there is sort of an overarching theme that, I think, has been reflected in much of our discussion today. We talked about, for instance, about traditional/nontraditional mortgages. We talked a lot about this sort of two-tiered system, which very much reflects two-tiered financial services markets as well.

There are regulated financial institutions which have safety-and-soundness regulations, Community Reinvestment Act, and other sorts of regulations, and then there is another set within the industry that does not have to comply with those regulations. This reflects very much the market that we are now seeing, which is people who are under-served by the financial mainstream and who rely on payday lenders and check cashers and others.

So we would like to explore this two-tiered financial system and to begin to develop ways to provide more consumer protections to people who fall outside of the mainstream.

VICE CHAIR SODEIKA: Thank you, Marva. Kurt, for the Consumer Credit Committee.

MR. EGGERT: Thank you. We have several different issues that we are facing, some for the first time, some carryovers from this and previous meetings.

A new issue is the Talent Amendment regarding a restriction of interest rates on loans to service men and women and their families. We understand that there are some interesting and significant issues regarding this, and we figured next meeting will be a good time to talk about that.

Another issue is open-ended Truth in Lending proposed rulemaking, which may be coming about at the next meeting. So that might be a good time for that.

A third issue is the FACT Act risk-based pricing policy issues. This time, we addressed the red flag guidelines, but there is also the risk-based pricing aspect of that to discuss.

A fourth issue is: We had an excellent report by Bruce Morgan on credit scoring and how that works. We didn't have enough time to have the follow-up discussion about the implications of credit scoring. So we anticipate hoping to have time to do that soon. Thank you.

VICE CHAIR SODEIKA: Thank you. And very importantly, and before we close today's meeting, I would like to mention that this meeting marks the last meeting for nine of our Council members. We have so benefitted from your participation, and thank them all for their role, their key roles, this past three years.

I would like to name you all, and welcome you to make some closing comments for us. Two of our members are not able to be with us today. Our Chair, Lori Swanson from the Minnesota Attorney General's Office, and maybe next year we will be saying the Minnesota Attorney General, and also Sheila Canavan of the Law Office of Sheila Canavan, also Forest Stanley of Key Bank National Association; Paul Springman of Equifax; Dennis Algiere of the Washington Trust Company; Anne Diedrick of JPMorgan Chase; Hattie Dorsey of the Atlanta Neighborhood Development Corporation; Bruce Morgan, Valley State Bank; and Mary Jane Seebach of Countrywide Financial Corporation.

Would anyone like to make some comments before we close our meeting? Yes, Hattie?

MS. DORSEY: You know, I never miss the opportunity. But I would like to say that this has been wonderful and very beneficial especially to me. I was saying to a couple of my colleagues that I just closed another mortgage. So all the information I learned in talking to the bankers around this table benefitted me in that negotiation.

I also would like to say that my staff sometimes would not welcome me when I came back home with stacks of papers that I insisted that they read, but the other side of it is that I do believe that I learned a lot, and I do say and I continue to petition to the Board of Governors that, you know, we are in an economic situation in this country, and it doesn't oftentimes benefit the least of us.

Sometimes when you advocate or even recommend to our legislators what needs to happen, your voices are heard better than ours. So I encourage you to continue to be another voice in the pipeline.

So thank you so very much for this last three years. I enjoyed meeting and working with all of you.

VICE CHAIR SODEIKA: Thank you, Hattie. Bruce?

MR. BRUCE MORGAN: Lisa, I would like to say you've got a very diverse and eclectic group to lead as we go forward.

To the Governors that are here, I'd like to thank you for the opportunity to serve on this Council. Your participation in the meetings and involvement has been very important, not only as you do your work, but it has been important to us as CAC members to have that opportunity.

I would also like to especially tell Governor Mishkin that Sandy and her staff are outstanding. Governor Bies knows that, and we really enjoyed working with them.

To the members that have endured the last three years, thank you for your active involvement. Thank you for your openness to alternative points of view, and thank you for your civility. When emotions ran high or people were passionate about a topic, we still could have a drink at the end of the day.

Personally, you know, a community banker, a bank owner, a chairman, president, CEO, myself, you don't always have the opportunity to sit down with this type of group. So that's been very valuable to me, and I say all those things in terms of my title as not a lawyer, not a lobbyist, not a consumer activist. Finally, for future Councils, Sandy, I commend your efforts at consumer research. I would hope in some of your future selections you involve more consumers in the Council as members.

I think the involvement of bankers who actually meet with consumers is important. So over the last three years as we discussed many of these topics, I sit down with consumers and have to explain all these forms, all these regulations, and they want to know the question, why. Well, it's for your protection. But I want my money, and I want it now. You don't understand. We can't give it to you until three days later.

If my good friend, Sheila Canavan, CAC Council member, were here, she would advise the Governors and Sandy to have fewer bankers, and I would say, Sheila, we need fewer lawyers.

VICE CHAIR SODEIKA: Thank you, Bruce. Anyone else? Yes, Paul.

MR. SPRINGMAN: To the Governors, I think what has been great is the seriousness which you have approached the CAC with. Each meeting, you are engaged and you are really sincere on the interest and the feedback, and that's been terrific.

Sandy, you've got a great staff. They help us not only at these meetings, but in between there's a lot of dialogue that goes back and forth, and they are terrific, and thank you very much.

To the members of the CAC, it's a great group. It's always a healthy and learning two days when we are here, and thanks for everything.

VICE CHAIR SODEIKA: Any other closing -- Yes?

MR. STANLEY: I just want to say it's been a privilege, and I hope we have served our task of helping the Board get information from both the industry and consumers.

One of the unintended benefits, and I think this goes for all of my colleagues, is how much we all learn and how much I've learned, and for that I thank all my colleagues, and particularly the staff. They have been outstanding. Thank you very much.

VICE CHAIR SODEIKA: Yes, Anne?

MS. DIEDRICK: This echoes everything that has already been said. I do want to thank Sandy for her leadership. I do want to thank the staff for their professionalism. I do want to thank the Governors for being so engaged. We were very impressed. Also, the Chairman has been coming to the meetings.

Finally, I just want to thank all my colleagues on the Council for your friendship, and I hope I get to see all of you at some point in my travels, and come to New York and see me.

VICE CHAIR SODEIKA: Yes? Anyone else?

MS. SEEBACH: I would just like to say ditto. It's been a great experience. I think it is absolutely right. Sandy has done -- you've done some powerful things with taking the staff and the division in a really positive direction, and it is wonderful to have the Governors as actively involved in this.

Having seen the CAC from both sides now, I have to say that one of the most impressive things about this is the frank and honest discussion remains pretty unemotional when it comes to this table, and I think the discipline of going through this process and being required to respect one another, to ensure there is a robust discussion today is a powerful thing that I never really realized about the CAC until this time. It's a great thing. So thank you.

VICE CHAIR SODEIKA: Thank you, Mary Jane. Sandy?

MS. BRAUNSTEIN: Yes. I, just like Hattie said, never miss an opportunity. I never miss an opportunity to have the last word.

Mary Jane, do you want to come back to work here?

MS. SEEBACH; Sure.

VICE CHAIR SODEIKA: I just would like to, on behalf -- I think I can speak for all the staff in DCCA and other staff even that's not in DCCA, people like Glenn Canner and Laricke Blanchard and others that have worked with you and continue to work with you, on saying we want to extend our thanks to you.

You guys have been great, the members. This Council is always a very unique experience and always a very positive experience. I know sometimes you may think that you are not having an impact, but I can assure you that you are.

I know in my conversations, I have the opportunity to talk a lot behind closed doors with the Board members, and they often will comment to me when we are discussing an issue, well, when I was at the CAC meeting, the members said such and such. I hear that from Governor Bies. I hear that from the Chairman.

So you are having an impact, and it is very important to us, and this Council is very important. One of the things that the Board members and the staff -- that we like so much about the Council is the diversity of opinion.

We have often felt that the purpose of this group was not necessarily to reach consensus on an issue, but it was to air all the views on an issue, because that does help us as we go forward with rulemakings and developing policy and guidelines and other kinds of issues that we are dealing with.

So for those of you who are leaving, it seems it always comes about very quickly. It doesn't seem like three years, but we want to thank you for your service.

Frankly, I don't think we will be strangers, because those on my staff can attest to the fact that we still have very frequent conversations with a number of Council members, former Council members, because as we explore issues, we are still going to be reaching out to you for comments and to have discussions and invite you to meetings for various things. So, hopefully, we will stay in touch.

Again, thank you very much. And for those who are continuing on, we look forward to a very productive 2007, and we will be welcoming a new group of people in March.

VICE CHAIR SODEIKA: Thank you, Sandy. Well, that's a wonderful way to conclude our meeting, and lunch is being served in Dining Room L, that way. Thank you, everyone, for your participation.

(Whereupon, the foregoing matter went off the record at 12:38 p.m.)