TRANSCRIPT OF THE
FEDERAL RESERVE SYSTEM
CONSUMER ADVISORY COUNCIL MEETING

THURSDAY, MARCH 8, 2007

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., at 9:00 a.m., Lisa Sodeika, Chair, presiding.

Members present:
Lisa Sodeika, Chair
Tony Brown, Vice Chair
Stella Adams
Faith Anderson
Dorothy Bridges
Carolyn Carter
Michael Cook
Donald Currie
Kurt Eggert
Jason Engel
Joseph Falk
Louise Gissendaner
Patricia Hasson
Deborah Hickok
Thomas James
Sarah Ludwig
Mark Metz
Lance Morgan
Joshua Peirez
Anna McDonald Rentschler
Edna Sawady
Faith Arnold Schwartz
Edward Sivak
Cooke Sunoo
Linda Tinney
Luz Urrutia
Alan White
Marva Williams

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

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(9:03 a.m.)

MS. SODEIKA: Good morning, everyone.

Welcome to our first Consumer Advisory Council meeting of 2007.

Before we begin, I would like to take a moment to acknowledge all the governors that are with us here today.

First, Chairman Bernanke, Governor Susan Bies, Governor Randy Kroszner, and Governor Frederic Mishkin.

Thank you very much for joining us and participating with us today.

I would also like to mention that this will be the final meeting for Governor Bies, who has served as our oversight governor, who is retiring from the Board at the end of the month.

And Governor Bies on behalf of the Council we just want to thank you so much for your participation and your support of the Council.

Thank you very much.

(Applause)

GOVERNOR BIES: I want to thank all the council members and all of your predecessors and hope you realize what a valuable contribution you make to all of us on the Board.

This is a unique ability for us, through the Council, to hear different constituents, look at the same issue. And the dialogue we have in this Council is so important in helping us think about policy and consumer community development issues.

I know it takes time for all of you to travel here for these meetings. We very much have appreciated your service, and I personally have got a lot of input every time I've come to one of these meetings.

And you will very often, in some of the final regulations we write your ideas, do pop up from time to time. We were just talking about one in something we put out last week that came out of one of these meetings.

So thank you for all of your service, too.

MS. SODEIKA: Thank you, Governor.

And I'm pleased to say that Governor Randy Kroszner is our new oversight

governor.

And Governor, you have been with us in some of our meetings last year, and thank you very much for your input and support, and we look forward to having you as our oversight governor on the council.

Thank you.

GOVERNOR KROSZNER: Thank you very much. I'm absolutely delighted to be able to take over this responsibility.

I'm really quite honored. I think Governor Bies has done just a fantastic job of integrating in the ideas that we gather here into our regulatory process and I look forward to doing exactly the same.

Thank you very much.

MS. SODEIKA: Thank you. Thank you.

I would also like to note that this is the first meeting for some of our new council members and I'd like to take a moment to acknowledge our new members:

Jason Engel from Experian; Joe Falk, who is a consultant with Akerman and Senterfitt; Louise Gissendaner, from Fifth Third Bank; Patty Hasson from the Consumer Credit Counseling Service of Delaware Valley; Tom James, Office of Illinois Attorney General; Edna Sawady, Market Innovations; Cooke Sunoo, Asian Pacific Islander Small Business Program; Linda Tinney of U.S. Bank; Luz Urrutia of Banuestra Financial Corporation; and who could not be with us today but also a new member, Terry Theologides of New Century Financial.

We welcome all of you, and we really look forward to your participation over the next few years.

HOME MORTGAGE FORECLOSURES

MS. SODEIKA: Our first topic today that we are going to start off with is the home mortgage foreclosure issue.

We will begin the meeting by discussing various issues related to home lending practices, foreclosure trends and foreclosure prevention programs, including our comments on the recently published federal financial regulatory agencies' proposal related to adjustable-rate products to subprime consumers.

Yesterday members of the Community Affairs and Housing Subcommittee discussed this topic during their committee meeting, and at this point I'd like to it turn over to

our committee chair, Stella Adams, who will lead this discussion.

Stella.

MS. ADAMS: Thank you very much, Lisa.

We had a very exciting discussion on foreclosure issues yesterday. And we believe that we'll be able to bring that same level of discussion to the larger group today.

For some of us on the consumer side, we feel like we are canaries in a coal mine, and that we said to the folks, this was going on and the canary has died. But the miners were sent in anyway.

And so it is sad for us to know that there are 1.2 million families at risk for foreclosure from 2006. And you will hear statements from members that as many as perhaps two million homeowners will face foreclosure in the upcoming year because of the various activities that have gone on in the marketplace.

We had information given to us from staff studies that were done that showed that the market has some hot spots in it, but that there was a significant amount of the problem comes in the subprime market, and with some of the products that are being discussed in the guidance may have had--played a role.

What we are going to do today in our discussion is we are going to kind of break it up into three parts, kind of talk about the foreclosure issue, the problem. And then talk about the guidance, some facts around the guidance. And then we are going to talk about what are we going to do for those--what can be done for the families that are facing this problem now, where it's too late for any prevention to be done, or any regulatory guidance that comes out now won't impact them, how is it that we're doing?

We are going to encourage people who were not part of our committee discussion to jump on in at any point along the way. But I do want to kind of start out by giving a face, a local face to the problem of foreclosure. And I'm going to ask certain committee members to talk to the board about what foreclosure looks like in their community.

And I'm going to start with Louise out of Cleveland, Ohio.

MS. GISSENDANER: Thank you, Stella.

I appreciate the opportunity to share with you some of our issues.

Again, I am in the Cuyahoga County area which encompasses certainly the City of Cleveland. And as some of you may know, we are--well, we hit the top of the list for

foreclosures. So it has technically devastated our city to a great degree.

While there are lots of personal devastation by the individuals who are experiencing, certainly, the foreclosure, the thing I'd like to bring home today also is the major impact that it's actually had on neighborhoods.

Recently, meeting with the mayor and some of his community development folks who actually have done a study of each and every neighborhood to determine what has happened in the city. And we have actually found neighborhoods with abandoned houses now of approximately 200 homes at a shot.

This is disconcerting because as you know we've worked extremely hard over the past decade to bring the city around to also change the makeup of the neighborhoods, and to really impact the neighborhood through sales, home sales, as well as new housing construction in the city of Cleveland.

In addition to that, many of the community development corporations that work as professionals in the market are now concerned because of the abandonment of these houses. It's impacting the services of the city, because all of those homes have to be boarded up, in addition to the fact that there is a strain now placed on the police services because of illicit activities, and other things that are now moving back into neighborhoods that really previously had experienced none of this.

So in the scheme of things as we look at the struggles of foreclosure, we just don't want to forget the fact that it is taking its toll overall on the cities, as well as certainly those individuals who again are experiencing it.

Again the result of this has been unprecedented in our community. And as we work hard to stem the tide of helping individuals, we certainly also are trying very very hard to save our neighborhoods.

Thank you.

MS. SODEIKA: Thank you.

I will now ask Patty to talk about what's going on in Pennsylvania.

MS. HASSON: We are located in Philadelphia, and we have offices in all the counties. So the problem isn't just in Philadelphia and the foreclosures that we are seeing, but there are pockets in Chester, Norristown, there are areas where people are being hard hit with foreclosures.

And the thing I'd like to emphasize today is that the counselors who meet with these individuals, there are very few tools for them to really help the client, to really get them out of this situation.

Many people come in too late in the process. They are looking to save their home at the 11th hour. We need to be getting help to those individuals sooner rather than later.

It is having a devastating impact on the city of Philadelphia. While there is great growth and a lot of building and new development happening, the individuals who are in a lower-income range who are truly being hit hard by the loans that they took, that they cannot possibly afford.

And I think it's interesting to note that, in talking to the counselors before I came down, a lot of them are still seeing people with typical mortgages. So when these 2/28s and 3/27s start hitting, I can only imagine how much more difficult it will be.

MS. SODEIKA: Thank you.

Linda to talk about Colorado.

MS. TINNEY: Good morning everyone.

I'm from Denver, and I know probably a lot of you have seen the news that we've been on the top of the charts for foreclosure for probably a year.

And we have about 28,000 - 30,000 foreclosures across Colorado. But the bulk of it is in the front range including Denver as probably the biggest piece of that.

We have a neighborhood, just to give you an example of the rather horrendous impact, we have a neighborhood in northeast Denver, very near Denver's new airport--well it's ten years old now, but--it's called Montebello, and it's a working class neighborhood that in some measures serves the airport. It's predominantly African-American. It's a lovely, beautiful neighborhood, brand new, almost all the housing is new.

And people got in, in many cases the reports are, with zero percent down; some of the more hybridized, risky loans. And right now that community of approximately 8,500 units of housing is about 25 percent foreclosed.

And when you think about the impact on the families that are foreclosed, and the children in those families that are now being displaced in their schools, not to mention the folks that are still living there and the values of their property going down, it's just heartbreaking.

We are working very hard, lots of folks are working really hard, to try to mitigate the problem. And one of the things that has happened, I'm happy to tell you, is that we have developed a foreclosure hotline for all of Colorado. And it's been operating about five months now, and there have been 10,000 calls.

And of those calls the bulk of them are looking for assistance with their mortgage lender/servicer, and they have found that approximately a third of those original calls have been withdrawn, so hopefully that means they've been corrected.

About half are lost to public trustee sales, so families are losing their homes. Are they joining the homeless ranks? Are they moving in with somebody else? It's a tragedy.

But the good news is, these 10,000 people are getting help that have called in, and hopefully there will be more, and we will resolve the problem over time.

There are other projects that are sort of in the earlier stages of other things we are working on, but this is kind of helping those people who are already in the problem while we're trying to resolve keeping people out of foreclosure and helping with financial education and some of the other means that we can all use to mitigate the problem going forward.

Thank you.

MS. SODEIKA: Marva, if you cold talk about Chicago?

MS. WILLIAMS: Sure.

What I'd like to talk about is the community impact of subprime loans.

We have heard a lot about the impact on individual consumers, but there is also a very significant impact on communities.

We conducted a study a few years ago which looked at the relationship between subprime loans, additional foreclosures, and loss in property values.

For every 100 additional subprime loans we found that there are nine additional foreclosures that are attributed to subprime lending. And this is from 1996 through 2001.

And this translates into a loss of property values in those communities of up to 2 percent.

And that may not seem like a lot, but in many areas of Chicago where there are concentrated subprime loans and foreclosures, this has a very dramatic impact on the value of people's homes as well as the ability of the local government to raise taxes, to generate taxes.

And basically what this has meant is a total loss in property values, in some of these communities, estimated to be between $600 million and $1.4 million (sic).

In addition to this, I mean these are--this is very traumatic loss in homes due to foreclosures and values, but there are also other community impacts because of subprime and predatory lending.

This is--makes for very unstable residential patterns. The funds that people are using to pay off these very high cost mortgages are basically not being spent on other kinds of household goods, and leads to a great deal of household instability.

MS. SODEIKA: Thank you.

Sarah, if you would talk about New York?

MS. ADAMS: Yes. I'm going to just sort of talk a little bit about the impact of foreclosures on neighborhoods in New York City, and add another dimension to the discussion we've been having so far.

I have a map here and some copies I'll circulate that probably nobody can see, but I'll circulate it.

It's a map that shows the five boroughs of New York City, and where all the mortgage defaults have been located. You know this is often used as a proxy for measuring foreclosure actions.

These are all the foreclosure actions filed throughout the city in a year's period. And what stands out very clearly on this map is that there is an overwhelming concentration of residential foreclosures on one-to-four family homes in communities of color.

What you see on the map when it comes around, you will see it closely, are these diagonal lines. And these are census tracts that are more than 50 percent black or Latino. And it's a very striking map, and it's part of the reality that many New Yorkers and New York communities are facing right now.

And each dot on this map should not be seen just as a statistic. It should be seen as a family that is going through financial crisis.

And many of the groups that we work with in New York are helping these families avert foreclosure. Many of these families are resorting to taking second and even third jobs in order to pay their mortgage. They are, alternatively, paying their mortgage and not other bills, taking very seriously what's at stake here.

So you don't even see on this map necessarily a lot of people who are struggling severely but haven't ended up in default on their mortgage.

So what ends up happening in these neighborhoods is there is a whole other set of foreclosure-related activities that is harming the same communities.

If you drive around these neighborhoods, what you see on virtually every telephone pole--and I'm not exaggerating; anyone who wants to come with me, I'll take you on a tour in a car--you will see that there are these yellow signs. And I think these are all over cities throughout this country. And they say, in foreclosure? Call us, 1-800 et cetera. Need fast cash? We buy homes. We pay cash. Come to us.

And what these yellow signs are, and what a lot of the other solicitations that people are getting directly by phone and by mail are from companies that are offering to bail them out of foreclosure. We will rescue you from foreclosure. You can stay in your home. All you have to do is write your title to your home over to us.

We will lease your home back to you for a period of time until you are back on your financial feet, and we'll then sell your house back to you.

These deals absolutely never work, and this has become a problem all over the country, this sort of deed theft epidemic that we are seeing in these same communities. So that's another layer of problems that is diminishing community wealth and that is harming families.

The other thing that is going on is, a lot of these homes that end up in foreclosure that actually make their way to an auction sale end up being bought by speculators who actually intend to flip the properties at vastly overappraised rates, amounts. So you get first-time homebuyers in particular who have never gone through the homebuying process, who live in these neighborhoods, who have been renting homes, who go to these companies that offer to help them with all aspects of the homebuying process.

They bought these homes in foreclosure. Many of them are in need of repairs. They make only cosmetic changes to the homes to make them look good. But in fact they work in collusion with inspectors and appraisers who are unscrupulous and don't correctly inspect the home; don't inform the prospective homeowner of what the actual condition is. People buy these homes at vastly overappraised rates, and then get into them and then they find out very soon that there are structural repairs needed, and it just sends them over the financial brink.

So, unlike Cleveland where you have the problem of abandonment stemming

from foreclosures, in New York where we have such a hot real estate market, you have a whole other problem, which is that there is a sort of false pushing up of property values, which is leading in turn to a pretty acute degree of unaffordability. You know we already have a problem of unaffordability of housing in New York but this is just creating entire swathes of the city with sort of vastly overappraised properties, creating comparables that are actually, if you had a legitimate appraisal done, that would show that these homes aren't worth as much.

So it's really creating a lot of problems for families and for neighborhoods.

MS. SODEIKA: Thank you.

I'm going to ask Ed to give us a rural Southern perspective on foreclosures. And he also has a unique perspective.

MR. SIVAK: I think it's important that, when we talk about foreclosures, and we talk about very urban markets, that we also talk about rural areas as well.

We obviously don't have the concentration of people in rural areas. Again, the effect is the same.

And I think one of the things that has been teased out in this conversation is the effect of certain products, and how--in looking at the relationship between products and people who have gotten into homes, the availability of credit through subprime loans in rural areas is just as prevalent as it is in any urban market.

Marketing tactics may not be as widespread. However, word of mouth in a rural community will make a product go just as far as any blitz marketing campaign.

I'd also like to talk about--just put on the radar screen a potential spike in foreclosures in Mississippi and Louisiana, and that's what we are facing when the foreclosure moratorium ends.

In October the moratorium will expire as a result of legislation that was put in place because of the hurricanes. And so as that event transpires we need to be thinking about ways to, both, prevent folks from ending up there, but also ensuring that for folks that do end up there, that we have things in place to help walk them through.

MS. SODEIKA: Thank you.

Are there any other members who want to talk about what the foreclosure picture looks like in your community that didn't get an opportunity to speak?

Yes?

MR. JAMES: Yes, I'd just like to add that looking at the raw--for instance in Cook County, I think when I started practicing law 25 years ago there were something like 400 or 500 foreclosures in the year I started practicing, 1981.

This year we are going to hit somewhere between 17,000 and 20,000 foreclosures in Cook County. Statewide it's probably double or triple that amount.

And just looking at those numbers doesn't tell the whole story, because many families bail out of homes before the foreclosure happens. And so we have many people who will get behind three or four or five months, and will give a deed in lieu of foreclosure or simply abandon.

So those numbers don't reflect the true reality of the problem on the ground.

MS. ADAMS: I think one of the things that is really clear from this is that the problem of foreclosures is widespread. It's in the West, it's in the South, it's in the city, it's in the suburbs.

We are facing a foreclosure crisis in this country, and we really need to try to get a handle on what the cause is.

I think in our meeting yesterday one of the things that we uncovered was that there is a concentration of the problem in the subprime market; that there is a distinct problem in the subprime market that is contributing to the foreclosures.

And I'd like to open it up. Joe.

MR. FALK: On behalf of the mortgage broker community, we have called upon Congress to urge a federal study on the foreclosure problem. Clearly there are some abuses, fraudulent acts by some originators, whether they be brokers, lenders, bankers or whatever.

There certainly has been a degree of appraisal fraud and other issues surrounding this.

There have been refinance issues, consumers using the rapid appreciation of their homes to pay their daily bills.

There are a number of factors that are drawn into this thing.

We believe, as the origination community, that part of the subprime problem is a lack of a clear disclosure on variable-rate products, especially the for-pay option arms where there is no payment shock sheet or payment disclosure at the time of application. There is no

final payment sheet at the time of funding that would include things like minimum payment and maximum payment; prepayment penalty options; whether there is escrow for taxes and insurance or other issues.

I think that disclosure is part but not all of the problem. And so we have urged that before draconian efforts are taking place into outlawing products or doing things that would harm the overall market, that we take a period of time--short period of time--identify the causal factors, and do this in an educated and studied manner.

MS. ADAMS: I think this is probably a good time to transition into our discussion around the proposed guidance.

And, with that, because this is long, we are going to switch off, and my vice chair, Ed Sivak is going to lead that portion of the discussion.

MR. SIVAK: Thanks, Stella.

I think this is a good time to start talking, in addition to the guidance, what are some of the things--you know we spent 25 minutes talking about the sky is falling, the sky is falling, foreclosures are here.

And so some things that I think we need to talk about which were in the guidance are, what about underwriting loans to the fully indexed rate? And really looking at a person's ability to repay. Whose responsibility is that?

Looking at stated-income loans, are they a vehicle for fraud?

Looking at--to quote one of the lines in the guidance--when you are looking at stated-income loans, higher interest rates are not a mitigating factor.

These are all things that are in the guidance that are important to discuss.

And I guess I'd like to kick it off with a story. Specifically around really emphasizing the importance of underwriting with the taxes and insurance included, we run a low-income tax preparation program in Jackson. And we had a client who came by, and she was excited because this was the first year she was going to be able to file her taxes with owning a home. And a lot of people think you can deduct the interest, it's going to increase your refund. And she handed over her statement. And I saw that there was interest, but the boxes for the real estate taxes and the boxes for the insurance were empty.

And so I said, well, actually your mortgage isn't high enough to--you don't have enough interest to deduct. You should take the standard deduction.

And then what that transpired into was a conversation about, well, what about my property taxes? Well, you are going to have to pay those. And that's $1,000 for her, she is going to have to come up with that.

And she said, well, how do I prevent this from happening next year? Well, you're going to have to take it out of - you know, you are going to have to have money taken out of your check. You are going to have to set aside about $100 a month to do that.

So I didn't get into the ins and outs of the product that she was in. But essentially that tax preparation program offered the opportunity to forecast the potential event. She didn't have the escrow in place. It was obvious that she was probably in a product where it was underwritten without that piece.

So I really want to emphasize how important it is that when you look at a borrower, you look at everything that has to come out of his or her pocket, because that is the situation that they face every day.

So with that I'd just like to open up the discussion. I see Alan--I'll take down names, and we'll go from there.

MR. WHITE: Thanks, Ed.

I did want to add just one or two comments about the scope of the problem before talking about the guidance and some of the solutions that we ought to be looking at.

Because this has gotten beyond a localized problem of pockets of little Katrinas all over the country. And I think it's important that we understand that foreclosures really are at a historic high, and they are going to get higher.

And there has been some debate about this in the public arena. The foreclosure numbers haven't entirely translated to the mortgage bankers' associations' inventory foreclosure rate. That's because the inventory rate is kind of a peculiar number where the denominator consists of mortgages mostly that were made this year and last year, because people are constantly refinancing, and the numerator consists of defaulted loans from the last five or six or seven years.

So things remain the same, but the volume of lending slows down considerably, which it's going to do this year, that rate is going to start creeping up very rapidly.

I think it's more important, rather than looking at percentages, to look at numbers. We know from various sources that about 1.2 million foreclosure filings were initiated

in 2006.

We have every reason to believe that it will be a much larger number in 2007 because the defaults--and a couple of other things about the numbers.

Fifty percent of the foreclosures were subprime loans. Remember that the subprime mortgage market, as a percentage of the total mortgage market, is only about 15 percent of the outstanding mortgages. But half of the foreclosures are subprime.

Looked at another way if we didn't have the subprime segment of the market we'd only have half as many foreclosures.

The foreclosure numbers that we are seeing from the end of 2006, particularly the early payment defaults, are very much related to products that are being sold. And there has been some debate about this too: well, is the problem the mortgage products, or is it just sort of a natural business cycle, and the end of the appreciation in real estate values? Is it unemployment?

Well, obviously a lot of factors contribute. But I think when you look at the early payment foreclosure rates, the early payment defaults and disclosure rates of some of the specific pools of loans made in 2006, it's hard not to conclude that the nature of the mortgages being sold has a lot to do with the foreclosure rates.

When you see a pool of Fremont loans for example where 13 percent of the loans that were originated in the first quarter of 2006 are in foreclosure, bankruptcy or REO by January of 2007, and then you go back and look at what the mix of those products were, and you see they are mostly interest-only loans that are made with no down payment and piggy-back second mortgages. At least half of them have no income documentation. Forty or 50 percent of them are in three states, California, New York, and Florida. You can kind of see how the factors coalesce to create these kind of dramatic numbers.

And they are numbers at the margin, but these foreclosures at the margin are really going to start impacting foreclosures nationally.

And 1.2 million foreclosures, that represents close to 2 percent of owner-occupied households. I think it's about 70 million owner-occupied households in the country. And it's getting to a point where that's a number that is considerably larger than the increase in the home ownership rate.

Then you look at the minority aspect that Sarah talked about, given that

foreclosures are concentrated in the subprime sector, and subprime loans are disproportionately made to black and Latino homeowners, you can see that the gains in home ownership for black and Latino homeowners are going to be reversed.

In fact the number of foreclosures you can predict for 2007 is going to be double the annual gain in home ownership for black and Latino homeowners.

So it's getting to a point where it is no longer an anecdotal problem; it's really a very broad problem. And it does relate to the nature of the products being sold.

The last thing I do want to say about where things are now is that capital markets are obviously going to correct the problem to some extent. But I don't think that the capital markets are going to self-correct the problem completely.

I think there are three kinds of market failures that ensure that we are going to continue to have problems with foreclosures unless we start some kind of principled approach to restoring sanity to the mortgage market.

And those three problems are: significant time lags in the feedback from the investors to the originators; the fragmentation of the industry that is created by securitization; and the fact that a lot of the costs of foreclosure are external to the entire market. And everybody has talked about that, and Marva's organization has done some really good studies.

If you turn those costs into dollars, you know, the costs of foreclosure that are borne both by the homeowner and the community, those are not paid obviously by the investors. The investors will lose money on the foreclosure, but the losses caused by the foreclosure are considerably greater than what the investors will lose.

So turning to the guidance, first of all, I do want to congratulate the Board and the staff for getting the guidance out and getting it out quickly, the draft guidance. I think it's an excellent signal to the market.

My favorite part of it is the statement that price is not a substitute for underwriting. And I think that is a fundamental principle that needs to be said, and said as often as possible, that we can't just eliminate underwriting for risk and say we'll solve the problem by charging higher prices. That is not good housing policy.

I also think that it is very important to take a critical look at these subprime loans and the welfare benefits and the welfare costs that they have created. And it's not clear to me that the widespread use of products other than the traditional amortizing 20- and 30-year

mortgage has been any great boon to the consumer welfare, to the housing market.

The greatest innovation of the American mortgage market in the last 100 years is not an innovation that was created by the market. It was created by the government in the 1930s, and that is the 20-year amortizing mortgage which eventually became a 30-year amortizing mortgage.

That's the product that made home ownership affordable and available to wide groups of American homeowners.

And it would be distressing to me if the market were allowed to drift along in a situation where the predominant product became the interest-only balloon loan or a negative amortizing product that, in the name of affordability, we go back to products that existed before the 1930s, and that were really speculation products and not affordability products.

So I definitely commend the approach that is reflected in the guidance. I think it would make sense in some ways to extend the principles of the guidance beyond the subprime market to prime mortgages that have similar underwriting problems.

And the lines between prime and subprime are getting blurred to some extent now anyway, as risk-based pricing kind of gets spread across the entire spectrum.

But I think clearly there needs to be a policy response, and that the market is not going to solve the problem by itself.

MR. SIVAK: Thanks, Alan. Faith?

MS. SCHWARTZ: Yes, good morning.

We had a really great morning yesterday. And it was pretty somber, because foreclosure is a horrible thing. And I do believe lenders believe that. I think they don't feel it always like the regional and community impacts do. But they work hard toward understanding what they can do differently and better.

This is a complicated issue. I think it is important to inform always what the facts are of the markets, and I look through the study the MBA created of just the housing statistics through the first half of the year in 2006.

And a combination of 33 percent of every loan made fell in the Alt A or the subprime market segment. Annualized, that comes out to be a trillion dollars worth of loans that have many of the characteristics talked about today: hybrid ARMS, interest only, some balloon lending, option ARMs I guess from the earlier guidance and the traditional.

But I think it's important to position that a third of the loans for some reason are falling outside of the standard Fannie Mae/Freddie Mac guidelines.

Back to Alan's point, if it was all a 30-year fixed-rate market, 15- or 30-year mortgage-backed security market, you wouldn't have had all of those other loans happening.

Capital markets are taking care of some of the worst of the subprime risk overlaying, and clearly, there is a lack of liquidity for high CLTV mortgages up to 100 percent in low FICOs.

All that risk layering that the Fed and others have cited as risky to overlay mortgages. So I do think there is some big correction going on, similar to when the last guidance came out in nontraditional on interest only. Interest only had already gone down to single digits from as high as 35 percent of the market at one point. So there is some capital market correction.

I'd like to speak back to what Stella had to say about kind of setting the stage in the prevention side. Not the solution, but when lenders can't get in touch with borrowers for whatever reason--they might be out of work, they might have a bad loan, they might should never have gotten that loan--but lenders have a hard time sometimes reaching those customers. Servicers work very hard to get in touch with them, and one of the early prevention solutions, regardless of what happened on the front end, is working with trusted third parties like Neighbor Works America and the Ad Campaign and Hope Foundation, of which 17 of the largest lenders in the country work with to get ahead of this, ahead of the next stage of foreclosures, the worries that people have of interest rate resets and other things.

That has made a difference, and we will be hearing more from that party at the next Consumer Advisory Board meeting.

But in the interim it is horrible, and I think that we do all need to work together to figure out how to minimize foreclosures. But I don't want to lose sight that the history on the hybrid ARMs in both the prime and the nonprime market has been such that they prepay, a majority of them, within two to three years.

So that big pocket of loans that has been made, and the ones that you are not seeing, of course, do sometimes refinance into a higher better mortgage; sometimes maybe another subprime mortgage; but I think some of the biggest companies in the country are looking at those statistics to inform the regulators, to understand that maybe those were a bridge

to a need of financing that is other than a 30-year fixed-rate mortgage.

So that's my feedback.

MR. METZ: I would like to focus my comments here on the guidance. And I guess as an initial point these are the guidance as we know just came out Friday, so these are sort of preliminary thoughts.

At first blush as a lender there is really--it's hard to argue with a lot of the guidance. We too have concerns about payment shocks affecting our borrowers. We too want to make sure that products are well disclosed, and that people understand the key terms of what they are getting.

Also, we are very much in favor of responsible underwriting. I mean that's good business for banks. But again, there is not much to argue there. But being a lawyer there are some things I will argue about.

(Laughter)

MR. METZ: I guess the concern I have, and it's a comment that Alan made, is how we take this guidance and use it for other products, specifically some of the nontraditional products.

And my company has a big push or a big focus on what could be--what is a nontraditional product, the payment option ARM. But we do that product I would say very differently than many others. I mean we underwrite it at a fully indexed rate. We just fully disclose it. We call the borrowers, as soon as they get the loan, and say, are you sure you understand what happens? Are you sure you understand how negative amortization works? And you need to make payments?

So we feel very good about the way we disclose it, and the way we underwrite it. We also have a prepayment penalty there.

Now the prepayment penalties are discussed in the most recent guidance. And a concern we would have is just applying the same process for prepayments to all loans where we would feel they are not appropriate in certain loans like ours, such as the payment option, where we do disclose it, where we have payment caps, and we do have protections for the borrowers.

Another point that is mentioned in the guidance is avoiding steering customers to products that do not have sound underwriting and consumer protections--I agree with that.

But you start to--when you apply that to the prime market, then you are starting to get into issues where you are kind of controlling what products banks can offer, and you are getting into this suitability discussion which I think we will maybe talk about later.

But it's kind of a slippery slope that we have concerns about. Again, we feel it's very appropriate the guidance for the subprime market, and this is the way it's written. But we do have concerns about extending it.

MS. CARTER: I'd like to also commend the Board on issuing the guidance and addressing the 2/28 and 3/27 mortgages.

There was some ambiguity I think when the first guidance was issued as to whether it covers those, and I'm really glad that the Board addressed that and issued guidance for these particular mortgages.

Again, we have only seen it last Friday--maybe it was Monday. My comments aren't - we will probably have more detailed comments later.

But I particularly want to commend the Board for its focus on underwriting, and for its focus on escrow, making sure that escrow is included when--that is the taxes, the homeowner's obligation to pay taxes and insurance, is taken into account when determining whether the consumer can afford to repay the loan.

MR. EGGERT: I wanted to take up--again, I would like to congratulate the Board on the guidance. I think it's an excellent step.

I wanted to talk a little bit about the relationship of underwriting and the market. We have heard people argue about the virtues of an unregulated market, and an unregulated market has increased home ownership, and that we shouldn't worry, that the market will correct itself.

The problem is, though, that the market has been one of the causes of the problem in that the market has driven underwriting in the direction that it's headed.

It used to be when banks held their own loans banks had a great interest in underwriting because they were stuck with the results of that underwriting. And so underwriting was something that they did to preserve themselves, their own safety and soundness.

For lenders who securitize, however, underwriting is no longer internally driven at all. Underwriting is purely externally driven. You go to the markets, you go to the people who are packaging the loans, and you say, what do you want from me? I'll do whatever

it is that you want.

For example there is a quote in one of the materials from a lender who said, "The market is paying me to do no income verification loans more than it is paying me to do full documentation loans." What would you do?

So he's saying, the market says, I don't want you to underwrite. I don't want you to look at their income very closely. I want you to create these risky loans and to sell them to me.

So here the market has affirmatively discouraged underwriting.

Now you might say, well, the market has learned its lesson. It's going to be underwriting more strictly, and so we can just back off and let it do its wonders.

The problem, though, is that even if in the short term it will regulate more strictly, what the market will do is regulate inconsistently. Sometimes it will regulate more strictly; sometimes it will be more loose. Then there will be a period, oh, we have to regulate more strictly again.

And it's this unreliable underwriting that I think is worse than either consistently loose or consistently strict underwriting.

And here's why I think that. Consumers to some extent develop assumptions based on the market that they experience. So if they live in a consistently strict market, underwriting market, as they did before securitization loosened things up, they plan their lives around, here is what I have to do to get a loan. Here is what I need to do, how I need to live my life.

If they live in a series of loose underwriting systems, what they will do is assume that, oh, I can take a risky loan because if I get into problems, I can always refinance my way out of it.

And that's what we've seen consumers do for the last few years. What's happening now, though, is as the market is reacting and tightening the criteria, many people who thought that they could safely refinance their way out of trouble won't be able to do that. So they will be punished because they relied on what the market is.

And so it's the inconsistency of market that is part of the problem. And it's the inconsistency that is driven by market-driven underwriting as opposed to the old internally driven underwriting.

So I think it's important that we recognize that the market is useful in many ways, but its inconsistency can be very problematic for consumers.

MR. SIVAK: Thanks.

Stella.

MS. ADAMS: One of the things I want to point out is that there--when we talk about the market and we talk about the risks to the investors, and the risks--the people who bear the greatest risk in this scheme are the borrowers.

Everybody is protected in the transaction through reinsurance, through investor pooling. Everybody has hedged their bets on these loans except for the consumer who was led to believe that they could afford this loan.

Many times, borrowers go into the processing, how much can I afford. And under strict underwriting criteria, they could afford a smaller house. But under the very loose stated income, hundred percent, you can – 2/28, you can afford X amount of house. And a lot of people are over extended, have bought more house than they can afford.

Even we have people in stated-income loans, a significant number of people in stated-income loans, who have documentation of their income, and it would have been cheaper for them to get a fixed-rate loan that they could afford with documentation, but if your documentation requires more work for the originator--I'm going to be nice to Joe and say originator--then it's less work for the originator to do no doc than to do what is required to document the loan.

And it's at the expense of that borrower. And so I always want to bring it back that everybody is protected in this except for the borrower and the neighborhood that, when you have a community where you have an entire subdivision where 25 percent of the homes are in foreclosure, that doesn't just impact those 25 percent of homeowners who are in foreclosure. It depresses the property values of the other 75 percent who have made their payments on time, and can afford to make their payments on time.

I think one of the things we learned yesterday was really how the capital markets are also contributing to the push towards foreclosure, in that some of the language in their contracts with servicers say that you have got to maximize the principal and interest that we, the investor, receive.

And in a marketplace where we are talking about 1.2 to 2 million foreclosures,

maybe it's not maximizing that needs to be done, but there needs to be some compromising done to make sure that we don't have a wholesale collapse of communities as a result of this.

And so I want us to get back, while there are--it may not be--everybody is maximized and protected through reinsurance and some other hedge funds and all of that in the investor level. At the community level, we are facing a pending disaster on a nationwide scale, it is no longer just little hot spots. It is a market that is depressed and depressing.

MR. SIVAK: Alan.

MR. WHITE: Let me make a comment that Stella brings to mind. Talking about the way the incentives work to get people into the different loan products, one of the stories that we hear about subprime mortgages is that they made credit available to people who couldn't get it in the past.

I think that is at best a half truth. A lot of what subprime mortgage lending has done is simply displace other products, often I think better products. And the illustration I see with my own clients, mostly African American low-income homeowners in Philadelphia, is the displacement of FHA.

If you look in the materials there is a very interesting table that shows the market share of FHA subprime and prime, and when you combine FHA and subprime that market share has stayed the same. It's just that subprime has completely displaced FHA.

Well, an FHA mortgage for most of my clients is cheaper; it's a better deal than the subprime alternative. But for the broker,the problem with FHA is that they do underwriting. And they do it very carefully. They come and inspect your house. They want documentation of everything. And it takes a long time. It's a big hassle factor. It's 90 days, sometimes longer, to go to closing.

Whereas the subprime broker and lender will get you your yes and go to closing in 45 days, or 30 days. It's much faster, especially if you do a no-doc loan.

Now the incentive for the real estate broker who to some extent is the trusted adviser for the homeowner is to get the deal done fast. And that's probably more important to that broker than it is to make sure the homeowner is not paying an extra one or two or three percentage interest rate, and is put into some dangerous product as opposed to a nice fixed-rate FHA loan.

So I think that is another aspect of kind of letting the market continue drifting

along the way it's been even with some underwriting correction that the market will do by itself. I think it is a problem that subprime has displaced FHA to the extent that it has.

On the solution side, I wanted to add, there was a very good discussion yesterday, because most of these mortgages and foreclosures are not held by banks or serviced by banks, they are serviced by servicing companies, the fragmented securitized mortgage market, and it's not clear to those of us who are concerned about this tidal wave that is arriving, that the servicing companies are going to double and triple and quadruple their staffs to deal with the coming waves of foreclosures.

And it struck us that it might be valuable for some of us--I think this was Joe's suggestion in the advocate community--to sit down with several of the major subprime servicers and talk about what is going to be done. Because although you hear from the industry, we don't want to foreclose, we reach out to borrowers, we have all these options available, I will tell you my experience in trying to call servicing companies, especially the ones that have a lot of foreclosures, is that I will send them financial statements, I will give them everything they need to do a workout, and I won't hear from them for six or eight weeks. In the meanwhile there is a sheriff sale scheduled, and it's incredibly frustrating for advocates, let alone homeowners who are trying to navigate loss mitigation on their own.

And I think housing counselors--Patty, you will probably agree--have had this same experience. And I can't see how it's going to get better. Servicing is not a profit center. And I don't know why servicers would suddenly ramp up their staffs just because foreclosures are doubling.

MR. FALK: Well, the mortgage broker community agrees with Alan. Hard to believe that, right? Because one of the problems we have in the market is that the FHA loan product, as many of us know, is in great need of reform.

The Bush administration tried to get an FHA reform package through Congress last year. It was not ultimately passed. And we are hoping that it is passed, but passed with one addition, and that is, that the mortgage broker community can in fact participate fully in the FHA loan program.

Part of the problem of the marketplace which is 50, 40, 60 percent dominated by the mortgage broker community, is that mortgage brokers can't create FHA loans.

So if we are allowed to participate fully in the FHA product, we will then be

able to pick the appropriate products potentially including FHA that might be a better product than some of the subprime products that are currently available.

So I would agree with Alan in that regard.

And lastly, what we see in the marketplace, at least from the origination community, is that the pendulum is swinging significantly. And my hope is that if we are coming out of a phase where underwriting has not been fully incorporated into some of these products, we don't end up with a pendulum that goes so far to the other side that it restricts access to credit; makes foreclosure bailouts, refinances and makes consumer advocacy community's work less valuable. But we need to stop, in my view, my hope is that the pendulum stops in the middle where we can all work together to solve this problem.

MR. SIVAK: Joe, let me just follow up with a question. And that is the question that the guidance specifically asked: is it going to restrict the ability of existing subprime mortgage--folks who are in subprime mortgages to refinance and avoid payment shock?

And in your experience, some of the things we have talked about, the escrows, underwriting to the fully indexed rate, do you see that type of guidance restricting that?

MR. FALK: Well, I do see that there will be some underwriting questions that have been put into the market. I think that is good discipline. A lot of the requirements, both in last year's guidance and this year's guidance, is appropriate in my view.

But if it goes too far, we will see a significant contraction of the market which will exacerbate declining home values and problems for consumers.

So I think it's a mixed bag is my answer.

MS. SCHWARTZ: Ed, I know we haven't really sat down with the guidance yet, to fully get through it. But I know just to share with you, there are lenders we underwrite with full escrowing and principal and interest. But if they don't get an escrow, then look on the back end to place, and I'm sure some other lenders at the table do the same thing, although other lenders do not. That is certainly a part of prudent underwriting.

Mandating escrows is another issue. I don't know what that would do the market, because while there are more escrows on subprime today than there were five years ago, there weren't many, it's very hard on the front end to do full escrows all the time, because the market isn't doing that.

But we have a program on the back end which has been quite successful in penetrating, and creating escrows for borrowers to budget for their taxes and insurance. So I just thought I'd add that.

MS. SODEIKA: I would just add on the guidance, Ed, I think that the guidance is prudent for sure to say that we should look at the affordability of a loan at the onset, to say that we should be considering taxes and insurance, especially if the customer is in a product right now that has that in their payment, to make sure you are comparing payments properly.

The thing that I get concerned about is when we narrow it to the nonprime consumer. Agree and understand that the nonprime consumer is the consumer that hits more bumps in the road, that needs more protection for sure.

But as a consumer, I just get uncomfortable when we start defining new guidelines for one segment of the market. I don't know how else to describe it other than it gives me a very uncomfortable feeling to select one pocket or one segment of the consumer base and say, these are the guidelines that apply to you, either because there may be a consumer that falls under that category who perhaps could benefit from a certain type of loan that may not be offered based on the new guidelines, or because as well there could be someone right on the cusp, right on the edge of getting into a problem, and the guidelines would not apply to them.

So if we are going to look at a consumer and say, can you make the payment based on today's income, based on a payment that will happen in two years or three years, ought that not apply to everyone if it's good for a piece of the market. That would be my concern and input.

MS. HASSON: In the prime market now, often, people escrow your taxes, I mean obviously, and you have the right to apply to them to do it yourself.

And I think there's a lot of people in the prime market who still, for their own budgeting reasons, allow their lender to do it.

And so I think requiring that--and I can tell you by the clients we see, the majority of them will keep it escrowed. They don't want that responsibility. They don't want that extra cash. They want it to go with the lender and be paid that way.

So I think you could still offer them that opportunity when their loan hits certain levels that there is equity in their homes, those types of things. You could come up with those guidelines to allow it.

But I think you have to afford them the opportunity to have it escrowed as it is in the guidelines.

MS. SCHWARTZ: Yeah, I would just like to echo Lisa's comments. We talked about it yesterday. We said, let's just clarify what subprime is. And I think we came up with, we think it's 6/60 and below FICO.

Again that trillion dollars spans a lot of segments of the market that fell outside of standard mortgage-based security markets. So I think it's important to understand in the market what the guidance will apply to more granularly than not.

So thanks.

MS. ADAMS: One of the things I wanted to emphasize or reemphasize that Lisa talked about was comparing apples to apples, and making sure the payment, when you say we are giving you a reduced payment, if that payment that you had before was in escrow, and included taxes and insurance, that then you are given a loan that does not include taxes and insurance, that that is explained to the borrower.

And that has not been with a lot of these loans. Borrowers have gone from escrowed taxes and insurance to what they thought was a lower interest rate, lower payment, only to find out that the escrow amount was not in there.

So I think it is--one of the critical pieces of the guidance is that in determining whether or not the person is qualified that you include that taxes and insurance as part of the affordability piece.

I also want to agree with Lisa that I don't know that the segmenting into prime and subprime is necessarily appropriate. But I will honestly say that the subprime market as it operates today operates really differently from the prime market. Because in the prime market primarily there is taxes and insurances included in the escrow.

The way the market--there is prudent underwriting in the prime market. There is a stable secondary market for the prime market in Freddie and Fannie guidelines that are transparent to the borrowers and transparent to the marketplace.

That transparency does not exist in the subprime markets, in the capital markets. Each one has its own little contract with its own little quirks. So there are significant differences between prime and subprime that if we level the playing field in terms of transparency, then you can really get to having one set of rules for one market.

But we really have two distinct and different markets. And the problem for the most part is concentrated in the subprime market. And so I think that we do need--I think it is great that the Governors have addressed this guidance, to address that significant problem that currently exists.

MR. SIVAK: Let me go to Kurt and then Alan--oh, I'm sorry, Governor. I can move you to the front of the line.

(Laughter)

GOVERNOR BIES: I just want to--the issue of scope is clearly something that we talked a lot about when we came out with the proposed guidance last week.

And as you all know, at the last meeting we had, I was reminded of scope on the nontraditional mortgage, the option ARMs.

What we really tried to do here is to emphasize principles that would broadly apply to mortgages. But we chose--and this is what we want comment on--we chose to title it subprime because we felt that the immediate attention needed to be on subprime.

But I would challenge you, if you feel it doesn't broadly apply, to let us know. Because I think we feel the principles that are in here should really be a foundation for any kind of loan to any customer.

But it was a decision on how to write the scope and everything. Give us feedback on it. But we didn't want to get caught up in how do you define subprime and all of that. We wanted it to be broader and more principles-based. And if there are issues around that, give us that feedback.

MR. SIVAK: Kurt.

MR. EGGERT: I'd like to talk a little bit more about the inconsistent underwriting that the market has created.

Too often we think that this a sort of a battle between investors and borrowers, and the more borrowers have to pay, the better things are for investors, and that it's a zero-sum game between the two of them.

However, I think in this aspect stable underwriting benefits both sides. And here is why I think that.

Investors who are buying the products that are the result of securitizing mortgage loans buy those based on the idea that they can price risk effectively; that they know

the risk of the loans that they are buying pools of, and are willing to pay for certain amounts of risks and reward.

However, recently they've discovered that the risk may be higher or much different than they expected. And a big reason for that departure from their expected risk to the actual risk is the loose underwriting. They didn't, I don't think, effectively price the far riskier loans than they thought they were buying.

And they run into two problems. One is that the loans seem to have a higher default rate than they've expected. And the other problem is that the investors, I think to some extent, depended on the idea that subprime lenders would buy back the early problematic loans.

And what we've seen is, if you have a huge number of bad loans in the pipeline, and so the investors are saying to the subprime lender, oh, you have to buy back all these loans, they can overload the lender. The lender says, oh, I'm out of here. I can't buy back all these bad loans. And so that is added to the risk that investors have seen.

So ironically this market driven underwriting has hurt investors at the same time that it's hurt borrowers. I think better, both sides are better protected by stable underwriting, and more stable underwriting than the market itself will impose.

So that I think is a good justification for the regulatory agencies to step in and say, we're going to help both investors and borrowers by imposing a stable baseline of underwriting, and allow everyone on both sides of the equation to make their decisions based on this stable procedure.

The folks who have benefitted most from market-driven underwriting are people who rely not so much on quality of loans but rather on volume of loans. And I think it is important to take the underwriting out of their hands, and put it in the hands of someone who can provide a stable basis for it.

MR. SIVAK: Let's go to Alan, and then I think we are going to go back to Stella who will finish out the discussion on what about the people who are in foreclosure.

MR. WHITE: I think on the question of defining the scope of the guidance and defining subprime, it's important to note that the it's the loan that is subprime, it's not the borrower that is subprime.

There are plenty of homeowners with 700 FICO scores, excellent FICO scores, who are getting the no doc loans, and therefore they can't get a loan that--I mean the definition

of subprime is a loan that Freddie and Fannie won't buy. That to me is the definition of subprime.

And so there is a certain logic in saying, well, if it's nonconforming in that sense it won't be purchased by Fannie or Freddie. We need to address it, because with Fannie and Freddie we have some confidence that they do underwrite based on repayment ability and not on collateral.

That is a sensible distinction in my mind. But I totally agree that the principled approach should apply to the entire market. And the principle should be that loans should be underwritten with the idea that people will pay off their mortgages, not that they are going to refinance every two or three years. That is a principle that I see in the guidance and I commend all the federal agencies for adopting; that you don't compensate for bad underwriting by having higher prices.

MS. ADAMS: The next part of our discussion, with the time that we have remaining, is to talk about what can be done, what should be done, what should we be thinking about for the 1.2 million families facing foreclosure out of 2006. And I think I saw an article on AOL that the tsunami of foreclosures that we are going to face in 2007, and what we around the table see as possible ways of intervening in this process to keep people in their homes and to protect assets.

And I think I want to start with Patty to talk about some of the things she's doing, and then go to Faith to talk about the initiative that the lenders are participating in.

MS. HASSON: I think one of the--or I guess that came up yesterday is when a counselor is, or when a client comes in who is in foreclosure, is, what are the options for clients?

And I think there is an attitude out there--and I believe servicing companies want to help people. I know it's difficult to get in touch with clients, believe me; we face that same difficulty at times. But the clients that come in to see us and in trying to help them, the solutions are not there.

And I think that one of the reasons is truly the connection. It is a very antiquated system in today's world. It's, you're on the phone. You are contacting them. You are mailing them a package. You are contacting them days later, trying to get in touch. There's a lot of time on our counselor's part that could be better used helping another client.

And I think that in today's world we could be doing a lot more electronically in

terms of having that conversation with servicers to get them the information they need, to develop a realistic budget, with that client, to make sure they can stay in that home; to do all--and use the tools that they have.

And I think we could have another discussion if we had a lot more time around whether or not those tools are really being fully utilized, like loan modifications, forbearance, those types of things.

I'd also like to add that in Pennsylvania there is a system. It's called--or there is Act 91, which is, when you are 60 days or more delinquent on your mortgage you can apply to the state for assistance. It is a good program--could be better, but it is a good program, and it is one way that we can help clients get some assistance to get out of loans.

I think that's what frightens me the most is, we are going to have all of these people. You are going to have very good programs like this, where you are going to get them to counselors, and counselors have very little in their toolbox to really help clients get out of that situation.

MS. ADAMS: Faith.

MS. SCHWARTZ: Yes, we talked a little bit about the distinction yesterday of loans on a balance sheet, or a depository institution where you might have some latitude in how you are helping work through borrower foreclosures, et cetera, and then securitization in the market. And what some of the constraints are, although they are not horrible, there are constraints. And so a few observations on how that works.

A lot of the private label securitizations allow you to modify, go through forbearance, et cetera, et cetera. But there are--we read yesterday from one of these securitization lawyers that we invited in to brief the group, I think it's weird, default is imminent. His interpretation on that, that you can't go solicit a current portfolio of loans who is doing great and then the third year they are facing a reset; they may not have their jobs, in fact, they may not be able to afford the reset, or they may be able to, but you don't quite know that.

If you go solicit those loans in a securitization that could cause a prepayment, there are some rules around securitization that you can't just go do that to say, let me help you keep your rate at where it is versus resetting. Once there is a problem with a loan, you can go out and work through all of those options.

Back to the point, it's hard for services to always get in touch with those

borrowers, they are not calling. There are behavioral instances of where they don't want to talk to the servicer, so they'd rather a third-party trusted adviser.

Therefore again there are 17 lenders working with NeighborWorks of America. It is probably the best collaborative effort I've seen, kind of public-private partnering with CCCS, and others, servicing and counseling at the table or on the phone, and getting people ahead of the curve--and that's really the key - it's for preventing, and part of the solution, before they get into that 90 days late, 120, and that whole different situation versus starting to have a problem.

And I think that's got to be part of the solution, is how a third party can help and bring them back to the servicer. It could be within the first 30 days of default. There could be good action taken. And often modification or forbearance can be had, period, in that securitization.

So there are good solutions, but it's when that borrower gets with their servicer and/or that third party. So the industry is working quite hard and I would even share that a number of us met with Wall Street and the rating agencies to talk through prospective issuing of securities, and what different ways they could be structured to think about minimizing problems, and helping mitigate that borrower foreclosure. So that type of thing is going on. It's not a full solution, but that is some activity.

MS. WILLIAMS: I also wanted to mention that I think community-based solutions are very important when it comes to foreclosure prevention, that having a trusted community organization that a resident can go to with their problems is really important, because they may not have that same kind of relationship with a lender.

The National Community Reinvestment Coalition has developed a consumer rescue fund that operates in 17 states, and they partner with local community organizations to help people who may be facing foreclosure or are in foreclosure or in danger of foreclosure. And their programs stem around primarily mediation with lenders to renegotiate terms of loans; to refinance into affordable loans; and also litigation.

An important component of this program is financial education also, to help people plan their finances, and to develop budgets that will allow them long term to stay in their homes.

MS. SODEIKA: I would like to add to that Marva. Because HSBC actually

started that fund with NCRC a few years ago. And it's really twofold, because we are actually taking folks who are in--it started out as an anti-predatory lending rescue program and it still is that. But it is also folks who are in higher cost loans who are in trouble and about to lose their home.

And we've rescued hundreds of people by putting them in 4 percent loans, 3 percent loans, whatever it is that they can afford to pay at a given point. But what we have found is that thousands have been saved because NCRC's counselors are working with the local community counselors and the originator to reconstruct that loan and to modify the loan.

So that we're finding that when lenders get a call from NCRC or one of their affiliates, they are much more willing to somehow work out a solution. And the borrower's also more involved, because they have gotten to a point where they are afraid to take the phone call from the lender.

And I'm going to put a little advertisement out for NCRC. At HSBC we originate the loans and we also fund the administration portion of the program. But there have been other lenders willing to fund the administration of NCRC's program but not willing to actually originate the rescued loans. So I will ask my lending partners here to consider actually originating some low-cost loans to help keep the folks in their homes.

MS. CARTER: One thing--I want to comment on the programs to help homeowners in trouble--one thing I wanted to express caution about is, one approach can be to invest a lot of time and money into a telephone hotline type of approach that provides a little bit of help to a whole lot of people but doesn't really get to the problem. I think that there is certainly a role for a hotline. But if there is a hotline type approach, it needs to be backed up by really robust referral, referral ability, referral to local organizations that can provide face-to-face counseling.

Another concern I have about an approach that puts too much weight on telephone help is that a telephone counselor in Denver is unlikely to know the community resources in Cleveland or Philadelphia that the counselor in Philadelphia can call on and put together.

And a final concern is that many of these loans are bad loans, loans that never should have been made. And a telephone-only system is not going to be able to examine the loan papers; instead at most it's going to be able to put the homeowner in touch with the servicer

to arrange for payment of that bad loan in some way, which only fuels--it only rewards bad lending.

MR. WHITE: I want to emphasize what Lisa said about the need for rescue loan products from good lenders.

We have a very small program in Philadelphia that is run through a local savings bank and funded by a local community development corporation, and also to bring in Carolyn's point, what we do a lot of, when we see foreclosure cases that involve fraud, and I think a considerable percentage, especially of the early payment defaults, are loans that involve fraud, which means that if the homeowner gets to a lawyer, it's possible to renegotiate the loan, hopefully, and agree upon some compromise balance that the current servicer will accept.

But then we need a product where we can get a new loan for $50,000 to get rid of that fraudulent $100,000 mortgage for example.

In Philadelphia we are currently in negotiations with Wachovia about their Community Reinvestment Act compliance. And we have tried to make the pitch to them that--and I would certainly make the pitch to the regulators as well--that a rescue loan product would be an excellent CRA product, and it certainly would be much more appealing than getting credit for doing subprime lending, or buying subprime securities, which apparently people are getting CRA credit for.

So I would really urge the regulated lenders to look at developing rescue products. And it means you have to do your underwriting in different ways. Because you are by definition going to have people who have a mortgage delinquency history.

So their credit history is impaired, so you really have to look behind the story and see, well, is that because this is a borrower you don't want to deal with, or is it because it's a borrower who got victimized by fraud.

And in that kind of underwriting, it's very hard to get lenders to actually do it. Fannie Mae has a product that they have done a couple of hundred loans, but this is all very small scale. It really needs to be scaled up.

MS. ADAMS: Kurt.

MR. EGGERT: We're talking about--there are two aspects to the problem we are talking about. One is looking forward on guidance on creating new loans, so that we don't have new loans that are problematic in the same way that the loans of the last year or two have

been.

The other one is looking backwards on what to do with loans already made.

Ironically, fixing the first problem may make the second problem worse. If we tighten the underwriting for new loans, that may make it harder for people with existing loans to refinance their way out of the problem.

Now the second problem traditionally is fixed by loss mitigation tactics of individual lenders. They have somebody who is in default; they work with them to try to prevent foreclosure. However, I fear that leaving loss mitigation to the individual lenders may cause problems for an industry as a whole if they each follow their own self-interest. And here's why I fear that.

If we have an environment of decreasing property values and increasing defaults, that gives lenders a rational basis to want to foreclose as quickly as possible if they think that they will have to foreclose inevitably. If they think, oh, I'll probably have to foreclose in a year or two; housing prices will be less; a bunch of the equity will have been eaten up by then. It gives them a reason to jump forward with very aggressive loss mitigation rather than trying to work things out.

I think that regulating agencies need to look at this as we have a problem, and what we should design is a way to figure out a soft landing; a way to look at these bad loans out there, and try to minimize the overall harm of bad loans that already exist.

And they should be looking at guidance on loss mitigation as well as origination. They have to look at both sides of the problem, because if you focus solely on origination, it may cause a hard landing, which would be in the worst interests of both consumers and of the industry.

MS. ADAMS: Yes, Governor.

GOVERNOR KROSZNER: Faith had mentioned the work that is being done by NeighborWorks of America, and I sit on the board of NeighborWorks of America, so I'm very pleased to hear this positive feedback, because I think NeighborWorks has been on the cutting edge of trying to think about exactly these issues of being there to provide some rescue, being there to provide some--really being an intermediary between the borrower and the servicer or whoever they may be dealing with at that time.

And so I don't want to take up the time here, but I very much am eager to hear

feedback from you about how NeighborWorks is operating, whether it's operating well, whether there are other things we could be doing, or if there are particular programs that you really like that we should be allocating more resources toward. That would be very valuable to know.

MS. GISSENDANER: In the Cleveland market, and actually northeast Ohio, we have about four NeighborWorks organizations who have been very successful in helping with the foreclosure issue, and particularly helping the individuals to get through some of the mitigation departments where the borrower cannot do it.

I just think there is not enough money to go around to assist, and one of the things that we have focused on is really contacting the county government and others to see if they have appropriate dollars that can be matched to those dollars in NeighborWorks' organizations, particularly as you've already heard our area has been extremely hard hit, including also asking financial institutions to also provide additional dollars, particularly since they have been so successful in making those homeowners be able to keep their homes in terms of the foreclosure situation.

So I agree that we have to be more creative. We have to think out of the box. We have to figure out ways that when we have organizations such as that that have come to the forefront, that they can in fact get additional dollars to make an even greater impact.

MS. ADAMS: Faith.

MS. SCHWARTZ: Just a note about NeighborWorks, they are a fabulous organization, and one of the premier NHS directors, Bruce Gotschall in Chicago, has been a great template for how a local community can work with banks, with the city government, with the Federal Reserve, and get extra dollars to match the abandoned houses, et cetera.

So he is kind of one of the NeighborWorks advisers on that. My recommendation to NeighborWorks has been, put more on the front end to understand what's behind every foreclosure. I keep hearing about all the bad loans. There are a lot of bad loans out there. There are also a lot of people in distressed economic situations without jobs. And pockets of foreclosure are also in tough markets where they've already had some economic stress.

I think while it won't be as good as a technical study, and I'm sure there is lots going on in foreclosure, we need them. I really want them to come up with what every one of those foreclosures has been caused by. And it's a multiple layering effect, no doubt. But I think

it would be quite helpful to the lenders. But I'll inform others such as the regulators who sit on their board. It's that feedback loop that's often missing and needs to be in these discussions.

MS. ADAMS: Tony and then Joe.

MR. BROWN: In regards to Ohio, as you know, Ohio has one of the highest foreclosure rates in the state (sic). And on the notion that the governor just asked, the governor in the state of Ohio yesterday just announced a foreclosure prevention task force, and is looking to create a refinance product that will help anyone who had refinanced or financed their home in any unscrupulous manner to be able to get some type of refinancing product through the Ohio housing finance agency. So I think that is good news for the citizenry in the state of Ohio.

MS. ADAMS: Joe.

MR. FALK: Yesterday, in the committee meetings with Stella, we discussed the possibility of sitting down with the--getting a group together, the consumer advocacy community, together with some of these help groups, together with the major servicing agents, and sit down and talk about real next steps that could be taken to facilitate some of these work out situations. And so one wonders if there is a role for the Fed to play in bringing the appropriate people to the table, sit down and talk about real solutions and real next steps, in a very short period of time.

MS. ADAMS: One of the things I want to point out, NeighborWorks and NHS is a great organization, but they don't have a lot of concentration in rural markets. And that's--we love NHS, but there are just not enough of them in North Carolina to help us with our problems. So that's one aspect of it.

The other thing is, we modeled--Patricia talked a little bit about the Pennsylvania statewide rescue project that helps people who are behind on their mortgages. The state comes in and helps. North Carolina entered a pilot program, a home protection pilot program, to protect homeowners, modeled on the Pennsylvania model. But because Pennsylvania has some flaws, they said, don't do this. Make sure you include FHA loans. And they kind of gave us some hints about things that they wish they had done in hindsight. And I think that the pilot that the--Ohio is talking about is also based on that same model.

One of the things that we created in our model was, that if we saw people had bad loans, the counselors screened, the state is not going to pay for predatory loans. They are not going to make the mortgage payment on a predatory loan. They are going to try to cram it

down to what the true value is, what it should be, and then the state will pay the mortgage. Because the program has the state paying the mortgage for people who have been displaced because of job loss for 18 months. But if this is a predatory loan, the state is not going to spend taxpayers' dollars fattening up a predator.

One of the difficulties in this is getting the cram downs from the servicers. Because the originators don't have the loan anymore. It's now in an investor pool somewhere. And they don't have anything to do with the terms of the loan. And getting them to agree to reduce the payment down to what the actual appraised value of the house is; it's very difficult to get the cram downs when it's necessary. And it's hard to then go to Lisa and say, write this loan at 5 percent when you are going to be paying off a predator to do it. So there's got to be some discussion about cram downs, and about bringing equity, really making it fair, and for the--it's got to be an equitable distribution of the pain, and that's not what's happening now.

Kurt.

MR. EGGERT: There's actually kind of a technical reason why sometimes it's hard to deal with the servicers of securitized loans. And the problem they face is, if the loan has been sold into a series of tranches, the different tranches may have different interests in the loan. So one tranche may have more of the principal, one may have more of the interest. And so if you tell them to rewrite the loan, the first question they ask is, well, which tranche is going to take the hit. Because it may be that if I rewrite the loan in a different way that distributes the principal tranche may get more, or the interest tranche may get more. So they may have different interests. So the securitizer may say--or the servicer may say, I would have to choose between the people I'm working for.

I call that tranche warfare.

(Laughter)

But that is a real problem.

MR. WHITE: Kurt, we have actually talked to some servicers of subprime securitized pools about this loan modification issue and taking a loss. And they tell us that most of the time the servicer takes the loss. And there is a reason. Even though in theory, they have an agreement with the pool that says, well, if there is an economic loss, and we are going to minimize the loss, and we are going to write the loan down by 10 percent to avoid a 50 percent foreclosure loss, we ought to be able to pass that loan onto the pool, and our contract says we

can, but we don't.

The reason we don't is because if we do that too much, next quarter they are going to go to some other servicer. And so there is this--it's one of these interesting examples where contracts are kind of ignored for various incentive reasons. So it's really coming in most cases out of the servicers' hides; at least that's what they tell us.

MR. EGGERT: Although think that's true as long as the defaults or the losses are below a certain extent. If they go above a certain amount, then it makes no longer any economic sense for the servicer to do it, and then that's when you have the real problems.

MS. ADAMS: Joe.

MR. FALK: But there is a secondary market for these tranches. And my understanding of the market--and candidly, I'm not an expert in this--but my understanding is that the tranches have already lost significant value, and they are trading. So to the degree that we could get the servicing agents and the various owners of these tranches together, if a tranche went from 100 to 80, or 70. Based upon this theoretical foreclosure loss, a new purchaser of that tranche who may have bought that tranche at 70 cents on the dollar may very well strike a new deal to increase the value of the traded tranche. So I'm not sure that it's as much warfare--those losses may have already taken place in the secondary markets, and real value can be created by renegotiating some of these provisions.

MR. WHITE: There is really a principal agent problem. Because you know there are two kinds of losses. There is the loss when it actually happens. You sell the house, foreclose, sell the house, you have a loss. Well, the servicer is not going to have any trouble passing that loss on, because you can justify that loss. You did your best, and this is what you recovered.

But if you do loss mitigation with a homeowner, you always have the nagging question, have you really maximized the recovery for the trust or not? And my experience is, from what I'm told by servicers, they are just not willing to take losses that result from home preservation loss mitigation. You know, writing down a loan but not kicking the person out of their home, that loss they are not really willing to pass those on to the investors; they just don't have the confidence that the investors aren't going to get upset if they do that too much.

MR. FALK: But if I bought a bond at 70 that has part at 100, and I buy a bond at 70, and I can figure out a way to mitigate my losses under the bond, that bond value goes up.

MR. WHITE: But you are misunderstanding how it works. The investor is just a bunch of mutual funds or hedge funds out there. They don't have time or the inclination to sit and negotiate about a $100,000 mortgage in a $100 million pool. The negotiation is done by an agent, a servicing agent. And when we ask them--you know, when you ask permission from the investor, who do you ask, they can't really answer that question. There is like no there there.

In theory there is a trustee; there is a national bank trust department that generally serves as the trustee. But they get a very minimal income from doing that trust function. And they really don't have decision makers that sit there and think about loss mitigation for thousands of loans. So the servicer ends up making decisions as an agent kind of guessing what their principal would want them to do, but having a lot of anxiety about how much their principal really trusts them to make those kinds of decisions.

MS. ADAMS: Yet what is frustrating for me is that we can't do, as a housing counseling agency, we can't do negotiation with a trust that amorphous, one loan at a time.

There has got to be a way--there has got to be a way--to come up with a systematic plan on getting these investors to say, okay, we don't want to put two million people on the street. That is not healthy for the--that is not healthy for the economy. There has got to be a way. I don't know where it is, but that's where I want the discussion to help me with. And Kurt and Alan, you help me kind of see the--there is this amorphous kind of gaseous blob out there.

(Laughter)

MR. FALK: It's called Wall Street.

(Laughter)

MS. ADAMS: I can't touch them, I can't see them, I can't even call them down to a room. I can't bottle them. But there has got to be a way to get them out of this gaseous form to a liquid or solid form where we can work out some kind of, yes, while it may be a toxic tranche, or tranche warfare, or whatever, but that there is some agreement that we can't do this one loan at a time, that we need to come up with a solution that says to the servicer, save the home for the homeowner, and do the best you can--you know, save me as much money as possible, but also, save these communities, save these homes.

And so I don't maximize my investment, but I don't--I'm not destroying the environment, the economies, local economies across the country. I am not tanking the real

estate market because of all these foreclosure signs. So there has got to be a way. And Kurt, help me understand where this--where the touchstone is on this.

MR. EGGERT: I wish I had a good answer. I mean one of the problems is, once the loans have passed to the amorphous, gaseous blob--AGB, as it's known in the trade

(Laughter)

--it's hard to control that. I mean who regulates the securitized investment? I think that shows the crucial importance of regulating it before it gets to the blob. And that's why I think we have to talk about things, like something that has been flirted with a little but we haven't really discussed its suitability. How do we make sure that only suitable loans get to be sold on Wall Street? And I think that is a crucial discussion. Because once it's in a tranche and you have a servicer overseeing it and a trustee very likely overseeing it, it's hard to deal with.

MS. ADAMS: Mark.

MR. METZ: Sure, I'll be glad to talk about suitability.

First off, though, I do want to talk about Alan, you know, Wachovia does have an outstanding CRA rating.

(Laughter)

We do have loan funds, like the kind that Lisa talked about. And we'll be glad to talk offline about that.

Suitability--and we could spend another hour, I think, talking about suitability--

MS. ADAMS: We've only got five minutes.

MR. METZ: Okay. Just some concerns I have about it. I think it opens up lenders to liability where you are being asked to substitute the lender's judgment for the borrower's judgment. It's a tricky dance. Lenders don't want to be criticized for having to give the best rate or the best product. Frankly we are concerned about litigation with that.

Having said that, there is room I think for common ground, and that's I think where a longer discussion comes in. Again products do need to be responsibly underwritten, and responsibly disclosed, and we do need to look at the borrower's ability to repay.

I guess where at least for my lender where we get into some concern is, again, is this the best product among an array of products that might be appropriate for the borrower? And also, and we talked about this the other day, are there certain safe harbors conventional

fixed-rate products where you don't even get to the suitability discussion? And you know you sort of put that aside, and you really sort of focus the discussion on really I think where it needs to be.

MS. ADAMS: Thank you. As you can see we had a fun time yesterday, and this is kind of the range of the issue, Kurt. So we applaud the Board for its guidance. It has given us room for discussion, but as you can see there are other issues out there that we still are having a hard time getting our hands on related to the foreclosure issue.

We thank you for this time this morning to share with you what is going on in our communities, and the complications that are faced not only by the consumer groups but also by the lenders in trying to deal with this emerging problem. And so we thank you for your time, and Kurt, we thank you for your generosity in giving us the additional time.

MS. SODEIKA: Thank you, Stella. That was a great discussion. Believe it or not, we actually had time to talk about a few other things yesterday. So next on the agenda is the model financial privacy notices.

MODEL FINANCIAL PRIVACY NOTICES

MS. SODEIKA: We'll focus on an effort by the federal financial regulatory agencies and the Federal Trade Commission to jointly develop an alternative financial privacy notice. The agencies are working together to design notices that are easier for consumers to read, understand and use, and could be used by financial institutions to comply with their disclosure obligations of privacy policy and practices. Yesterday members of the Consumer Credit and the Depository and Delivery Systems committees discussed this topic. And we are going to ask Kurt Eggert, the chairman of the Consumer Credit committee, to lead this discussion.

MR. EGGERT: Thank you. As you know, the federal regulatory agencies are required with the FTC to jointly develop model privacy forms regarding the sharing of consumer information. The challenge here is to provide privacy notices that accomplish two essentially contradictory goals. One is to provide consumers with a fairly complete description of a financial institution's policies regarding disclosing nonpublic information to both affiliated and nonaffiliated parties.

The other goal is to do that in a way that is clear, concise, and easy to understand. The challenge is, even if you tell people what your goal is, to give them a clear and complete description of financial institutions' policies regarding disclosing, by the time you have

gotten that far in the sentence, most consumers' eyes will have glazed over and they will have no idea what you are talking about. So how do you disclose to them in a clear and concise way something that is somewhat difficult to understand?

The goal is to give them a way to make an educated decision regarding privacy, and you want to allow them not only to comprehend an institution's policies, but also to compare the policies among different institutions. Few consumers even read privacy notices, and fewer yet understand what they are reading. So the goal here is to get through that barrier, and I think the way that has been used is a good one. What we have seen is a testing of disclosures--that is very important--and the principles of testing that have been used, I think, are useful for all disclosures generally. And some of those principles are, to keep it simple, to focus on the few most pertinent facts. Another principle is that standardization is very effective. You want people to be able to learn the disclosure once, and be able to use what they've learned over and over from all different institutions.

And the other thing that we have seen is that the disclosure table itself is crucial. We have limited the amount of time on this topic in part because there wasn't a huge conflict between members on this, but we would like to give you a taste of what we discussed, and so I'll start with Joshua.

MR. PEIREZ: Thanks, Kurt. And I'd like to commend the Board, the other agencies, the FTC, for incredible work on this. I think we do agree that the proposed model disclosure is a huge improvement perhaps from the status quo. And actually, Kurt, you used clear, concise, easy to understand. As I look at it, it really does achieve I think five S's: it's simple, it's short, it's straightforward, it's standardized, and it provides an important safe harbor.

I think the problem is in doing all five of those things it's very likely that unfortunately there is limited utility for financial institutions to the disclosure, and it won't be as widely used as I think the agencies and financial institutions would like them to be. And I think it's really because of one critical piece, which is that the scope of the safe harbor which is well within what the Board and the agencies are authorized to do in covering Gramm-Leach-Bliley notice requirements, unfortunately doesn't cover state liability.

I know that is not something that the agencies can necessarily deal with, and may require a legislative solution, unless there is some way to have a disclosure that various different state laws may apply within the disclosure, and we'd have to think about that a little

more. But as different states may or may not require actual disclosures, the disclosures that a financial institution may make in this model form may mislead a consumer as to their rights under state law or could otherwise be inaccurate relative to disclosures that had previously been given by a financial institution of rights that may apply to a consumer under state law.

It's also I think further complicated by the effort to include the FCRA affiliate opt-out notice within the disclosure. And I would encourage an alternate disclosure form be developed that does not include the affiliate opt-out piece within the Gramm-Leach-Bliley disclosure, and I think that is within the Board's authority. If you look at Section 503(b) of Gramm-Leach-Bliley, it does make clear that the Gramm-Leach-Bliley privacy notice has to include the FCRA affiliate sharing disclosure, but it then says, if any, within the notice. And if you look at the FCRA affiliate sharing notice, it is only required to be given one time to a consumer. It's not required to be given on an annual basis as the Gramm-Leach-Bliley notice is required to be. So it may well be the case that we may be able to have an alternate form without the FCRA affiliate sharing piece. And the reason that's important is that when you look at the simplicity of this, the problem is that embedded within it are two different types of information about a consumer. The Gramm-Leach-Bliley information, which is the nonpublic personal information that's generally been interpreted to be personally identifiable financial information, versus the FCRA consumer information which is generally a consumer report, goes to creditworthiness information, and that is handled in the model through a parenthetical saying, creditworthiness information, which I think is something that most consumers are not going to understand by that simple statement within the notice.

And since at least under a technical reading of the FCRA with Gramm-Leach-Bliley's notice requirement, I'm not sure you need to have it there. It may be that we can improve the utility, and increase the utility of the model form, by not requiring, or not having at least, explicitly in the model form, that FCRA affiliate, or having two alternatives, so that a financial institution could use the model form without the affiliate sharing piece.

But I still think the state issue is something that will have to be dealt with, either through some disclaimer in the form or over time through a legislative solution because you can still be subject to various state laws, unfair trade practices, or things like that that the FTC itself has brought cases under federally. You could see that under the state Unfair Practices Act, and we've seen instances where we've been sued in class actions, as have banks, where in

fact the disclosures have fully complied with Truth in Lending or other things, and the courts have so found. But then they found under some unfair trade practices theory, under state law, that liability could still exist and we feel we've got great appeals and everything, but you are just not going to pursue cases on that. You are just going to give a longer notice that covers you on the front end rather than having to test that later. So I'd encourage the agencies to give a little more thought to how to perhaps resolve that within the form. Because we think it's a great form, and we'd love to see it widely used, and it really allows I think for the critical goal of an apples-to-apples comparison of how different financial institutions use data, which is something that I think an informed consumer may well choose when shopping for products if they can penetrate it, which under the current regime they clearly cannot.

MR. EGGERT: Mark.

MR. METZ: Just some additional comments. First off, I agree with Josh's comments. We commend the Board on the form and particularly the table aspects of it. It makes it much simpler to understand and easier to read.

Our research has shown, I guess, several things. First, that while customers really don't completely understand privacy notices, that isn't their real issue. They care about more than what's in the privacy notice. The two things that they have identified for us are, number one, they want to understand how they can stop getting marketing calls, either from affiliates or from others.

And the second part, which we've incorporated this in our form as well, is, how do I protect myself from fraud? What happens if I'm a victim of identity theft? Who do I call? How do I deal with it? And then sort of the third comment, and this is really not--this is more of a legislative fix--our view is really to put the emphasis up front at the time you establish the relationship, and to really work with people there in helping them understand their privacy rights. We have found that having to send it every year, I think often times consumers don't even read it after they get it, and really the money is better spent and the effort is better spent at the time the account is established.

MR. EGGERT: Faith.

MS. ANDERSON: Good morning. Yesterday when we were discussing this form someone mentioned that why doesn't it use the term, opt out, which a lot of consumers are familiar with. What the form does, it uses the term, limit sharing. And someone suggested, well,

why don't we use that term and put it in this form? And I'd like to just point out that a lot of institutions, especially smaller ones like credit unions, we don't trigger the opt out because we don't share in that way. And so if you decide to use the term, opt out, I would just ask that in the definition section, if you put it in there, just make it optional that if your institution doesn't trigger an opt out, that you don't need to use it.

And I also commend you that you kept it to two pages if we don't have the opt out. We also believe that a lot of consumers want to be taken off marketing lists and do-not-call lists, and so what we try to do is, we also try to educate our customers that they can get off those lists. I just want to point out that if you make it mandatory to use the words, opt out, we will get calls from our customers, our members, asking to opt out, and because we try to be service friendly, the only thing that they opt out of is really our marketing materials, but they are our customers so we don't want to do that. So we would just ask that you don't make it mandatory to use the term, opt out, because it'll just confuse consumers where there is no trigger for an opt out.

MR. EGGERT: Jason?

MR. ENGEL: Thanks, Kurt. I really just want to amplify Josh's really excellent comments on this, and also to commend the Board in its efforts on this to get to a simple notice, and to use the design consideration that dictates that the document be neutral and objective, and not promote a given action.

There is enormous complexity here, and I know it's frustrating because people want a simple notice, and you think it ought to be something that is susceptible to a simple notice. But you are layering GLB along with an opt out provision that was added in the 1996 amendments to the FCRA, along with an affiliate sharing marketing provision that was added in the FACT Act, and I think the tension between comprehension and making this simple and compliance has been twisted maybe a little bit too far toward the comprehension, and the notice may misstate some of the actual provisions of the law, and in particular, with the affiliate sharing for marketing solicitations.

That particular provision, as it's written in FACTA, and now in the FCRA, is a prohibition on the use of data transferred by an affiliate for solicitation. The notice provision I think as it's currently drafted may be simpler, but it's drafted as an ability to opt out from that transfer in the first instance. So the lawyers looking at that will say, well, it's not an accurate

notice because it's not really what I do. I'm going to transfer that experience data to my affiliate. They may give the notice to prohibit solicitation for marketing, not the transferror entity, and so that notice wouldn't be used simply because of the accuracy aspect of that.

I guess I'd close by encouraging the Board to harmonize the notice itself with the final affiliate marketing rule, since if that remains as part of the notice, it really needs to be part of that final product.

MR. EGGERT: Carolyn?

MS. CARTER: The new notice is, or will be, a much needed improvement. I applaud the Board for taking the initiative on this. The privacy is very important to consumers. The existing system of notices was designed to fail. Those were notices--we've all seen many of them--they were designed to be ignored, designed to be impossible to understand. They were nonstandard, full of legalese, couldn't compare one to another. So this is just a breath of fresh air, and it's great to see.

I would--in response to Josh's comment--I would favor allowing institutions to customize the notices to comply with state law if they are subject to different state law requirements and still retain the safe harbor, because that would encourage--I think make it possible for more institutions to use the--to switch to this much better notice.

And my final comment is that the Kleinman study, I think, has a lot of lessons for other things the Board is working on, and particularly the on the open-end Regulation Z review. I think you are already moving in this direction, but first, of course, it involves consumer testing.

Second, some of these lessons are really just written about the Schumer Box, some of these points. Standardization is highly effective; it helped consumers recognize the notice and the information in it as they became familiar with the prototype. They learned where to look for differences. Standardization reduces cognitive burden because consumers recognize the information without having to continually reread notices word for word. The disclosure table is critical, as in June when we are probably talking about the open-end credit proposal, I hope we'll be able to say, yes, it met these standards that you commissioned with the Kleinman report.

MR. EGGERT: Patricia.

MS. HASSON: Hi. I think it's a great form, also, and I commend you on that. I

do have one comment to make from the consumer's standpoint, in that when that--or how many--or at some point can we do some kind of analysis of how many consumers actually use the form, how many opt out? I think there is a lot being done around behavioral economics and financial choices today. And if it was an opt-in form, probably most people wouldn't send it in either.

So by opting out, people are going to have to take action, so it will be interesting to see this simpler form, and we really don't have a basis to say how many opted out even before that, but how many are going to opt out, versus if we told people to opt in, to let people share their data, you probably would have as much inaction as you will, is my belief.

MR. EGGERT: Well, thank you. We applaud the Board for its work in this area, and also thank you for allowing us to comment on it.

MS. SODEIKA: Thank you, Kurt. We will take now a 15-minute break, and we will start our next topic at exactly 11:15.

Thank you, everyone.

(Whereupon at 11:01 a.m. the proceeding in the above-entitled matter went off the record to return on the record at 11:16 a.m.)

AMENDMENTS TO REGULATION E

MS. SODEIKA: Thank you. We want to make sure we have plenty of time for our Member's Forum, which is coming up in just a bit. But our first next topic is on amendments to Regulation E. There are proposed amendments to Regulation E that would create an exception for certain small dollar transactions from the requirement that terminal receipts be made available to consumers at the time of the transaction. Yesterday members of the Depository and Delivery Systems subcommittee discussed various aspects of this proposal, and I would like to call upon that committee chair, Faith Anderson, to lead us in that discussion.

Faith.

MS. ANDERSON: Good morning. Historically, consumers tended to use cash when making small transactions. However, recently, with the influx of debit and credit cards, consumers are more comfortable using debit and credit cards for these types of transactions. Currently when a debit card is used at a point-of-sale terminal, a receipt must be given to the consumer showing transaction information. Presently the receipt requirement applies regardless of the transaction amount, so if it's only a dollar, a receipt still must be given.

The receipt requirement is seen as an impediment in giving consumers the

right to choose whether they want to use their debit card or their credit card, and a lot of merchants who would like to use the debit card see the printing as a major liability due to the cost of installing, servicing, and maintaining the printers. And because of the implementation costs, and also, consideration such as whether a consumer really wants to keep their receipt for these small dollar transactions, the Board has proposed an exception from the terminal receipt requirement for electronic fund transfers that are in amounts of $15 or less.

Our committee has been asked to give our comments on this, and I'd like to ask the other committee members who didn't participate in our discussion to also join. We'll be looking at questions such as, is an exception from the terminal receipt appropriate? And how frequently do consumers request receipts? And then later on, we'll ask is the $15 threshold appropriate? So I'll just open up the floor. Josh?

MR. PEIREZ: Thanks, Faith. And I would just like to commend the Board and staff for working so expeditiously on what we believe is a critically important change to Regulation E. And it may seem very small, not just because of the small dollar amount, but actually because it is a very minor overall shift. But it can have huge implications in the marketplace, we believe to the great benefit of consumers that are increasingly choosing to use debit cards. As everyone I think is aware, debit card growth rates vary depending on whose study you want to look at. But they are, at a minimum, in the high teens, maybe even approaching the 20 percent mark year over year, in terms of the usage by consumers.

In particular, though, they also are very much used when cash or checks might be an alternative, and in this case we are talking about those small cash transactions. And what we have seen is the increased flow of transactions from paper-based transactions to electronic transactions, and that is now encompassing areas like vending machines, transit systems, parking meters, other facilities like that, even the U.S. Post Office's vending machines where you can avoid the one-hour line to buy stamps by buying them at the vending machine right inside often.

However, there is one distinction between Regulation E and Regulation Z that makes it very easy for these--for merchants that sell these types of goods to accept credit cards but makes them unable to accept debit cards, or makes it at least economically not viable for them to do so, which is that Regulation E always requires that a consumer have available to them a receipt upon their request. It's not that the receipt always has to be given, but it always has to be available to the consumer at the time and place of the transaction; whereas Regulation Z

does not have a similar requirement for credit cards.

So what we have seen is that these transit systems, vending machine owners, etcetera, will install the necessary equipment to accept cards. But the additional expense and technology involved to install the receipt machines actually becomes prohibitive, and they do not install them.

Additionally for these smaller ticket amounts, you are not looking at large dollar amounts for consumers to keep track of. So I think it's important to note that this exception, if the Board were to adopt in final form the proposal, although we would encourage one slight tweak of a $25 hurdle rather than $15, and I will go into why in just a moment.

We think it's critically important to recognize that the only merchants who will actually avail themselves of this exception are merchants that are only selling goods under whatever threshold you set. Because if that merchant is selling any products above that threshold, then they still will have to have receipts available to consumers in order to accept debit cards under Regulation E, so those merchants will end up only accepting credit cards or only accepting cash--when I say only accepting credit cards, I mean as an electronic form--and won't provide the debit card option to the consumers in that store.

So that's why we think the $15 threshold is actually just a little bit too low. Because even if you look for example at the postal service vending machines, as stamp prices continue to go up, you do see items there that fall between the $15 and $25 threshold such that those machines would not be able to accept debit cards without installing the necessary paper readers, and the postal service is unlikely to incur that expense. So consumers would then have to go online in order to use their debit cards there. But the same is true for commuter rail systems and parking facilities in cities where there is a great benefit to making them unattended terminals, but to do so and then have to provide a Reg. E receipt rather than just a quick receipt that states what was bought, how much time was paid for, et cetera, as an expense that won't be undertaken by the owner of the facility.

So we think this is a hugely important thing. We really do not think--and I know there are some of my colleagues on the Council that may disagree with this--but we do not think there is a huge negative for consumers on this. They do retain their rights to challenge the transactions. They are relatively set dollar amount transactions so it's pretty easy to see if it's the right amount, or if you know you made the transaction. And certainly those consumers who

don't want to make debit transactions unless a receipt is available to them can simply choose not to use their debit cards in these environments, which frankly is no worse off than they are today because today they cannot use their debit cards in this environment. So what we wouldn't want to see is the Board undertake to keep the rule as is, and thereby prohibit the many people who would want to use their debit cards for under $15 or under $25 transactions, even though they couldn't get a receipt, and thereby restrict them in order to make an environment where the other consumers were sort of protected from themselves, where they could just choose to not use their debit cards in those environments.

MS. ANDERSON: Carolyn?

MS. CARTER: Josh and I had somewhat different viewpoints in the committee discussion. First, I'm concerned that we're chipping away at EFTA's consumer protections. Rolling back the receipt requirement, and at the last committee meeting we discussed bounced-check fee rules. And at the same time consumer groups have asked the Board to consider improvements that would strengthen Reg E. For example, electronic fund transfers, the rules currently facilitate Internet payday lending. It's how Internet payday lenders get their--get consumers to pay them. These are often overseas companies. Consumer groups have asked for the staff to consider some improvements to Regulation E that would create greater consumer protections for those electronic fund transfers.

Consumer groups have asked the Board to consider extending Regulation E to cover telechecks or demand drafts. These are remotely created checks that are supposedly authorized over the telephone which fraudulent telemarketers use as a way to get money out of people's accounts. And I believe the AGs at one point asked the Board just to ban this altogether since it was so associated with fraud.

We have asked--consumer groups have asked the Board to clarify some mixed messages to banks about their duty to stop payment on recurring electronic fund transfers upon the consumer's request. And it seems to me that these topics should have at least the same urgency as the rolling back the paper receipt rule.

For receipts I wanted to emphasize that Regulation E just requires that the receipt be offered; it doesn't require that a receipt be forced upon any consumer. And if you look at the consumer comments, according to the Board staff, for the consumers who have made comments on this proposal, the predominant view was, they wanted receipts, and they had good

reasons for wanting receipts; first, to keep track of the money in their back account. When I pay with cash, I can't spend that money again because it's gone. But when I pay with a debit card, unless I have--unless I have a system for keeping track of how much money I have left in my bank account, I could easily find myself overdrawing. And consumers wanted receipts so that they could balance their checkbook and avoid overdrawing.

Now $15 may sound like it's not enough to overdraw anyone's account. But for consumers living on the margin that's a significant amount. Plus this could be used many times during the day. It could be used on a daily basis for transit. It could really be a large part of a consumer's daily budget. Second, consumers may need these receipts for reimbursement under employer transportation reimbursement plans, tax purposes, travel expense purposes. Third, I'm concerned that by not offering a receipt it really undermines the consumer's dispute rights, because the consumer wouldn't have any proof of what the amount was that was spent on that transaction.

Now Josh assures me that his company will always accept the consumer's word even if the consumer doesn't have any proof in a dispute with the vendor; but that's not necessarily an industrywide standard. And besides, by the time my bank statement comes 30 days later, am I going to remember whether on January 12th I had three $15 transactions or just two? There's really no way I'm going to be able to identify whether there was an error if I haven't been able to get receipts for these transactions.

And dispute rights are particularly important with debit cards, because unlike when I'm paying in cash, I can count my change, when I get my change back and correct a problem right away. But with a debit card, I use my debit card, and then the process after that is invisible. At some other time, in some other place, some other entity, takes some money from my account. And I just have no means of verifying that unless I've gotten a receipt, and then examine my bank statement when it comes. So for all of these reasons I urge the Board to rethink the approach it's taking with this rule.

MS. ANDERSON: Josh.

MR. PEIREZ: I just want to make sure everyone is clear that when Carolyn said she and I disagreed yesterday, we didn't disagree on whether the Board should look at all those other consumer protections. We certainly would be open to looking at any proposals on those. We simply, perhaps, had some disagreement about whether this actually exposed

consumers to any heightened risk. And certainly whether that risk in any way outweighed the great benefit to consumers of being able to use their debit cards in these environments today, which we think would be a tremendous advantage, especially since these environments are choosing to go to electronic and card-based payments anyway. So they will go only to credit card payments if this receipt requirement is not loosened, or at least at the $15 threshold, although we really think the $25 threshold provides a better breakpoint. And indeed in our own system we've required receipts for over $15 in the past; we've moved that threshold ourselves to $25 just based on the fact that we haven't really received any consumer complaints about the lack of their having had to have signed receipts for under $15. So our experience just based on the lack of complaints--and we certainly get plenty of complaints on other practices--so the fact that there were none on this does lead us to believe that it's perhaps not something that is a huge consumer issue.

MS. BRAUNSTEIN: I just wanted to pose a question to both sides. I mean frankly the discussion is what I envisioned it would be. And in trying to make this decision, is there any data out there as to how many or what percentage of people actually save those receipts and use them as opposed to tossing out receipts for small transactions? I mean is there any way to gauge how often there is any reason they are needed?

MR. SUNOO: We talked about that actually yesterday. And anecdotally, we know that in fact a number of us actually pick up a receipt and if it matches, great, then we may dump it. But the fact that we look at them, I think that one of the issues is the importance of having that ability--in the immigrant community we do a lot of financial educational, financial literacy work. Our mantra to them is, keep your records, keep track of your money, keep track of what you are spending, and how you are spending it. And I think that if in fact you use your debit card and have no receipt, it is impossible--you are not going to jot that amount down, or that 800-number on there where anybody can call for a receipt. When buying a can of Coke or--I know this wouldn't apply, but I recently bought an iPod from a vending machine in Macy's for $150. Clearly I'd get a receipt for that.

(Laughter)

The point being that somewhere between the 75 cent can of Coke and the $150 iPod, there will be plenty of transactions, and I would suspect as the ease of using vending machines increases, and the use of debit cards where I don't have to come up with a fistful of

quarters to buy a $4 sandwich on a vending machine, the vending machine industry and automated transactions, the level of what you can buy will also rise. But the danger here is for all of us, especially with the low- to moderate-income community where spending $10, $15 goes up to $25 in a shot, and doing it very quickly without a record, can quickly bankrupt a person who is paying on day one out of a 30-day cycle, having to pay their rent on day 25, and realizing when they get to the bank, oops, I ran out.

Carolyn pointed out that in cash we can budget the money, you can take $20 out of the ATM and hang on to that, when it's gone, you know it's gone. Continually use that card, it does not happen. And I think the speed of the transaction would have been--or encourage people to forget that they made that transaction. I think it is important to have that ability. If I buy my pastrami sandwich out of a vending machine for $7.50, and don't have a receipt, I may not realize that, oh, I took the super pastrami sandwich and it actually is $12.50. I'll know that if I have a receipt. I think for those reasons, especially to the LMI communities that has to deal with those issues.

MS. ANDERSON: Stella.

MS. ADAMS: This is something that I think I want to reiterate in terms of money management for not just low- and moderate-income people, but for people who use debit cards as a way of not bouncing checks. You need to be able to kind of know what that account balance is, particularly when you have attached this--now that it is possible to overdraft on a debit card, which is something that most people thought you couldn't do. If the money wasn't there you couldn't get it. And so a $5 pass without a receipt may send you into overdraft and cost you $35 in fees. It's really important to have that receipt to be able to monitor the money, and if you are going to have a debit card and use it, for daily transactions, to be able to keep up with it. So I just want to reiterate that for a lot of folks the debit card is a money management tool that they have instead of checks to keep out of trouble, and the lack of receipts on these little bitty transactions can end up maybe costing them a lot of money on the back end.

MS. ANDERSON: Josh.

MR. PEIREZ: I think Sandy, to answer your question, data is elusive on this, and in particular it's elusive because the channels that you would be talking about--allowing to accept debit cards through this environment--don't take them today, or if they do, they shouldn't be. And in fact we've been involved in many conversations where we've had to have vending

machine operators shut off the debit card acceptance recently in light of this receipt requirement, becoming aware of the fact that they have gone ahead and started accepting debit cards. And it's actually a more pronounced issue, because the liability under Regulation E by statute is on the lender, even though the lender is not the one who has signed up the merchant and is overseeing the merchant's acceptance of cards.

So they can't possibly enforce it. So while I do sympathize with the fact that there are consumers out there who would like to have receipts for every purchase, those consumers shouldn't use their debit card where they can't get a receipt, and I presume they won't if that's a fiscal management issue for them. They can still use their cash that they are using today in those environments. But there are many, many consumers who don't necessarily keep their receipts that are today precluded from using their payment of choice by the fact that the receipt requirement, the receipt being available requirement is there in some of these channels.

And so I do think, we talked a little bit yesterday also about whether there should be a disclosure that receipts are not available so a consumer knows before they go to make the transaction they are not going to be able to get a receipt in connection with that transaction, and we and all those in the industries that would be impacted by this that we've spoken to do not oppose that requirement that there be a simple sign that says, please note, no receipts available. And that might be something that would at least alert those consumers who would really want a receipt for that transaction that they perhaps shouldn't use a debit card if getting a receipt is something that they want.

But I do think it is something that we could certainly see if there are problems that arise over time. But at the end of the day the alternatives that are presenting themselves are having those consumers only have the option to use credit cards or cash in those environments, or adding the ability for consumers who want to use debit cards to use debit cards. And I think many of the consumers that people are concerned about not getting receipts for their debit cards, if they don't have the cash in their pocket, may well turn to their credit card. And they are not going to get a receipt for that either. And then I'm sure we'll be sitting here talking about how all these small transactions have increased the debt of those consumers who shouldn't have been using their credit cards to buy their pastrami sandwich or otherwise.

So we just think that consumers should be given a choice to use their payment vehicle of choice in these environments, and that requires the acceptance of debit which is,

practically speaking, precluded because of the receipt requirement as it exists today. And frankly, at the $15 threshold, will still be precluded in many channels.

MS. ANDERSON: I'd just like to add--this is a consumer choice issue, and just by allowing--we should give consumers the option of whether they want to use a debit card or not, and whether they want a receipt or not, because as Josh mentioned, they can get a receipt if they use a credit card, or try to find some other means.

Maybe I'm too trustworthy, but I started collecting receipts, but then I realized then when I'd go on a trip I would start cleaning out my wallet, and I just ended up throwing them out and shredding them. So what I do now is, I don't even get a receipt even when I do an ATM withdrawal because I'm just afraid that my balance is on there and I don't want that to be seen, and so I think it just depends on the consumer. And maybe we need to do more consumer education, especially for those that need to know how to responsibly use their debit card.

And I would like to also add that while I think the $15 current threshold is commendable, I believe moving it up to $25 would just make it easier for consumers--I mean I know we don't want to have to be affiliated with the card trade associations and whatever they do, but I think just $25 seems like a magic number versus $15.

And I'll turn it over to Mike.

MR. COOK: First I'd like to commend the staff--I think they did an excellent job on this issue. However, I would suggest that there is an additional benefit that they did not address here, and I hope you don't think I'm crazy on this, but I think there is an environmental benefit associated with this as well. And I'll give an example that I gave yesterday where we're looking at some technology at Wal-Mart that would allow the printing of receipts on both sides of thermal paper in our stores.

It would reduce our use of paper at our point of sales by 32 percent. That 32 percent reduction annually would result in the saving of 40,000 trees per year. It would eliminate 4,300 cubic yards of landfill waste. It would save 5 million kilowatts of electricity annually. It would save 318,000 gallons of diesel fuel annually. It would reduce CO2 emissions by 5,000 tons and save 45 million gallons of wastewater.

I use this example as not that double-sided printing is going to save the world, or whatever the case may be. But when you start printing receipts for a 70 cent Coke out of a Coke machine; when you start having those type requirements for a pack of cigarettes, whatever

they are now, who knows. But whatever the case may be, when you start forcing receipts in that case, you are going to find them on the floor; you are going to find them on the street. It's just going to create additional waste in the environment. And I just--I really think that whenever we--if we argue that this is going to solve the issue of people writing it down in their checkbook or wherever they manage this, that is not going to resolve that issue by having that receipt. I just don't believe that that's going to resolve that issue.

MS. ANDERSON: Carolyn.

MS. CARTER: I am going to nominate Mike for an Oscar award.

(Laughter)

But I want to point out--

(Laughter)

MR. COOK: I told you people would laugh at that one.

MS. CARTER: I want to point out that EFTA and Regulation E only requires that consumers be offered receipts. It doesn't require that the receipts be forced on them. So I think that it probably won't save all 40,000 trees. It might save a tree or two, but that would be for the consumers who wanted the receipt, needed the receipts, and were going to use the receipts.

CHECK HOLDING PRACTICES

MS. ANDERSON: Anybody else? Thank you for hearing our comments on this topic, and we we'll go and move right along to the check holding practices. Under the Expedited Funds Availability Act implemented by Regulation CC that governs check holding practices by setting a schedule of when funds from deposited checks must be available. For the discussion today we are going to be looking at the availability of official checks known as cashier's checks, certified checks, teller's checks, where next-day availability must be given by the financial institution.

And unfortunately or fortunately, cashier's checks, because they are a great tool, they are usually in the thousands of dollars--they are not usually a $20 cashier's check. However, consumers today don't realize that just because funds are available does not necessarily mean that the checks have cleared. And scam artists have realized this, and as more folks are going to ACH, they are using cashier's checks to the vulnerable people. So I'm going to turn it over to Anna to give some examples of how consumers are duped, because there are

losses on the consumer side, innocent consumers, and then also on the financial institution.

MS. RENTSCHLER: Thank you, Faith. I want to start with a couple of examples that we've seen run through some of our affiliate banks and I've talked to many banks in our area, primarily Missouri. One of the examples I would give is, we have a longtime older customer. They come into the bank. They deposit a substantial size cashier's check. Just because this person doesn't normally do a $50,000 transaction doesn't make us stop and say, why aren't you doing this, why are you doing this, et cetera. But the check is accepted readily, the teller will check their account, and they have $150,000 in the bank, whatever, a sizeable deposit relationship. So no verification is really taken on this, because we've known them for a long period of time.

They put the money in the bank, and then a few days later they come into the wire room and make a transfer of funds--unbeknownst to them, it's to a fraudster. Then the cashier's check is returned as fraudulent. We banks are then in a type of conundrum in that we've got a wonderful customer, a longtime customer that knows everybody in the community, and in small communities they talk to everyone, so we have to work that out with the customer. Well, there's a $50,000 check. Does the customer take the loss? Or, do we say I'm sorry, you should have known better than to deal with this fraudster, and all of a sudden we are going to take this $50,000, lose that customer, and then they do talk to everybody in town like I said. And why did your bank not know that that cashier's check was fraudulent? And meanwhile due to this transaction many would have life savings squandered.

Another example, along similar lines, we have a long-time customer that comes in, but they don't have a lot of money in the bank, but they are a long time customer. We know who they are. They bring in that large cashier's check, and we do a little bit more due diligence, because they don't have a lot of funds within the bank. The due diligence is checked out. They come to the compliance officer or the head teller or whatever they want to do. We go to the Polk's Directory to look up--meanwhile the lines are growing in the teller line.

What they do is, they call the bank, and we got hold of--after several transfers, we'll get hold of somebody in the bookkeeping department of that bank on which the cashier's check is written. They'll say, oh yes, that's within the series we are currently issuing. A lot of times we can't get hold of the person that could validate that--I'm going to pick on Marva--Marva did purchase the cashier's check made payable to Josh Peirez for the amount of $50,000.

We're not going to get that type of an answer most of the time. They will say, yes, it does appear valid.

We'll place a next-day hold on that item in the hopes that a large item return would have been spit out, because it's greater than $2,500, or it meets the 24-hour deadline. But most times these cashier’s checks that are fraudulent do bounce around in the system somewhat, so we don't get that return. In the meantime, that customer has wired out the funds out of our wire room a couple of days later, and then when that check is returned, the customer then has no funds and no means to repay that. We generally then take a loss on that item and/or make a loan to that customer, but it may very well tie up their home for an additional 30-year period. We get into some type of loss mitigation standards.

So first of all, those are two examples that I've run into substantially, these are larger checks than we normally run into. What we find is that when most of our customers bring in checks and deposits, if we place a hold, or not, they are usually smaller type checks that they do in the normal course of their business. And what happens with the larger cashier’s checks, they assume that they are the gold standard. They are an obligation of the bank. They feel that they are going to be good. Yes, they have probably been duped by a fraudster that has coached them, or probably cultivated the relationship over a longer period of time than just a day or two. They bring that in to us.

We then try to go with the Regulation CC holds as they are currently written, and give next-day availability. If we have a good reason to believe that it is fraudulent, yes, we will place a longer hold on that. But some do take quite a bit of time to come back to us, and we find out that they are fraudulent. Fraudulent cashier’s checks, as we said, are generally large in denomination. We might be able to place a large item hold, but that would only protect us for a limited amount of that. For the most part our customers believe that the cashier’s checks are genuine. They often, as I said, have been coached in how to deposit the item, and how to wire the funds out.

Yes, they are going to get some gain out of it. Maybe there is a little bit of greed involved there. But sometimes when we are dealing with the elderly, maybe the uneducated, those that deal with a paycheck-to-paycheck type situation, they see the fast returns, and all of a sudden they've found themselves in a loss situation. So this has been an issue that has come up numerous times within the Missouri Bankers Association and my affiliation

through them, people talking about how do we best see that and take care of the situation.

Education is critical. We do need to educate our tellers, and we do educate our tellers--watch out for the larger cashier's checks. We do need to take some type of due diligence in order to make sure that we can verify that that check is good. If the fraudster is really good we are not going to find that out. And it is well too late, and then the loss is to the bank and to the customer by the time we find that out.

So we also need to train our customers, but that is easier said than done. The alerts that were given out by the OCC and the FTC, I applaud them for that. However that came to the banks, and it just reverberated with us that we need to talk to our tellers and possibly coach our customers and get it out there. But it is a loss situation that we need to look at. And the hold periods for the cashier's checks generally impede our ability to hold within a time that we feel is appropriate to retain and get the check back as good.

MS. ANDERSON: I'd like to echo Anna's comments. Unfortunately a lot of this really is customer education. But sometimes even when you're face to face with a customer it doesn't work. I have a great example where one of our customer members received a letter. It was a Nigerian scam saying, how would you like to receive $20 million? You just need to wire these funds. So he approached our CEO and said, how would you like to have $20 million in your credit union? And our CEO told him this is a scam. You can't do it. And he thought he really got through to this member. But unfortunately, he didn't send in money, but the last question this member had was, well, what if it's true? I mean you've just got to nod your head like, no, it's a scam.

And we've had other instances where a customer wanted to sell their manufactured home, but they didn't want to pay the 6 percent commission to the realtor. So they sold it over the Internet. Well, the buyer was somebody from overseas, and said, I'll pay you your purchase price, plus I'll give you something extra because I want to buy furniture for my grandparents. And because of various mishaps, we didn't get the check back later, realizing it was fraudulent, until 30 days later. Now this poor customer is paying us off, but it's going to take her over ten years. And so it really does get to the consumer.

Some regulatory agencies do have education about fraud on their web sites, but not all do. And then while some do issue the alerts, not all do. And also it's a manual process. You know you will look at it on the web site, but it's not something that is automated. So unless

a teller has that in front of them, or it's a Friday afternoon, they just want to get through that line, they are not going to look down and see all the numbers. And really these checks, they are very well made. I mean you can't tell. They are just with the printer, and they are quality. It's not just that you can see, oh, this is a fraudulent cashier's check. So there needs to be more done, I think from a national point of view, because I think for example some institutions, you know we are only in our small area, but we don't see the national trends that are out there. For example, we found out there were fraudulent post office money orders in New York. So once we realized that then we were able to crack down on that. But really a lot of consumers do end up losing money. And then unfortunately, you know, they have bad credit because of that. So then we always have to make the choice: we know they're innocent. Do we still charge them for it? Or do we just kind of say, okay, it was just a bad case of misfortune.

So really it is an issue out there, because the people that these fraudsters prey on, they are the desperate. And that's why they so much want to believe that they won this Canadian lottery, even though they never applied for a lottery ticket in Canada. So a lot more needs to be done I believe from a national level and from a regulatory point of view.

MR. COOK: I would, from my perspective, I doubt that the fraud issue will be resolved with any legislation or regulation that could potentially take place, and that has to be resolved through education on the fraud side.

However, I would instead suggest that we focus on improving the system that clears checks between banks. And I think the folks here at the Fed have probably heard me preach this before, is that as the primary clearinghouse for checks, the Fed does have a significant responsibility in this issue; that the timeliness of clearing check items, if I'm not mistaken, within the last five years--I'm not sure if it's 13 or 17 check-processing centers that the Fed has closed, but there are a significant number of processing centers that have been closed, but there has been nothing to enhance the clearing of checks between institutions to improve that system. In this case if those checks had cleared overnight like they do in many other countries--Canada for example and the UK--we wouldn't be in this situation where people are wiring funds the next day out of their account, and that check would have come back immediately as NSF or nonsufficient, whatever the case may be.

I believe that the second piece of this is the stringent enforcement of the requirement of the paying institution that they return the item in a timely manner; that they not

claim that, well, I only received it three weeks after the original receipt of it, and now I am just now sending it back because it sat on somebody's desk. That second piece, I would encourage any institution that received an item back in a delayed manner like that to push it back to the original payee bank for nontimely return of that item.

But I would again encourage that we look at improvement in the check-processing mechanism itself, versus additional legislation or additional fraud prevention on this item.

MS. ANDERSON: Governor Bies.

GOVERNOR BIES: Let me--I want to clarify where we are on electronic presentment of checks. The Fed, pushed and got passed Check 21 a couple of years ago, and initially as this product was rolled out, it was very slow to catch on because for banks to receive items in electronic form versus paper, the whole back office system where they get the items and post it to customers' accounts was all paper based. And so they have had to make significant changes in the back office.

In the second half of 2006, we are seeing a marked acceleration of banks' ability to receive electronic checks, and we are forecasting now that within a few years most checks will be presented to the account holder's bank in electronic form. So this will speed up, as these back office issues get addressed. To put this in perspective we are already seeing checks decreasing, but we have cut our 45 centers down to 22 and still declining, and so we are planning on this evolution. So in the next couple of years, because the back offices now can receive electronic, you are going to see marked increases in the ability to receive. It's not been sending electronically. The other thing stores like yours, where you truncate the check at the register, so the check never gets presented. It goes through the ACH system. Technology may at some point allow us to merge more the ACH and check systems too.

So there is a lot of evolution. It's picking up speed, but the real issue is getting the technology since everybody's application systems in their back offices spoke different languages. And so--that is moving, but it's been very slow. But we are just seeing a marked increase in the speed at which electronic presentment is growing.

MR. COOK: I would just comment on that. I would agree that Check 21 was a major leap, and I believe that the NACHA and the group that are working on the ACH enhancements have been fantastic to work with.

If I look at that scenario, though, and the ability to capture that information, even if it's at a bank, and present the item, even at a memo post scenario, where you are able to identify, is that a legitimate account? Was that check ever issued? That maybe the following item has to clear with that Check 21 item, or the paper physical item itself at some later date.

But even if there is a mechanism that was able to identify that check directly to the payee institution, it would be very beneficial. And there has to be some ownership of the paying institutions that elect not to participate in these payment systems, that they have some additional responsibility of the fraud that they are adding to the system by not endorsing or embracing these technological advances.

MS. ANDERSON: Anna.

MS. RENTSCHLER: One other thought came to mind, since I'm now in the BSA world, the--I think the public at large is knowledgeable about some fraud that is going on in the cashier's check world, whether you use PayPal or whatever you are doing. So they are not accepting cashier's checks. They might sell their car. They might do some other purchase or sale. They are not dealing in the cashier's checks, so they deal in cash. And what we're finding as it comes into the banks and being deposited at the tellers, so the BSA world's lights start going off, woo-woo, and here we've got all kinds of additional SARS that we are filing. So if we don't get one system corrected, we are going to be inundated with another. So we are seeing an influx of a large amount of cash in people's accounts that we have never seen before.

MS. ANDERSON: Carolyn.

MS. CARTER: At our committee meeting yesterday, there was one suggestion that hasn't been made yet, and it seems to me that there ought to be a law enforcement approach to this involving Treasury and the FBI. It seems to me that the ease by which cashier's checks can be counterfeited undermines the payment system, just like ease of counterfeiting United States $20 bills undermines our currency. And there were suggestions about requiring security features; requiring some standard format for cashier's checks so it's easier to identify what they are supposed to look like, rather than having a whole array of banks each branding them differently.

Also looking at a central database that would be more accessible, we heard in the committee about banks that would call up the paying bank and not get cooperation about whether this was a legitimate check or not. And of course sometimes the paying bank doesn't

know the details. I don't mean to be just blaming the paying bank, but it seems to me that that is an approach that ought to be explored.

I also wanted to follow up on what Governor Bies said about check-clearing times in a more general way. Another issue that this relates to is the hold periods, not for cashier’s checks, which have a separate provision, a shorter provision in the Expedited Funds Availability Act, but also for ordinary checks. There are billions of ordinary checks processed every year, and under the current rules those--the check hold times for those are two days for local checks and five days for nonlocal checks.

If the study that the Fed is just about to finish shows a significant speed up in check-processing time, I really hope that the Fed will exercise its authority under the Expedited Funds Availability Act to reduce check holding times. And I think I speak on behalf of many other consumer groups when I urge the Fed to do that. That's the--a five-day delay means an awful lot for a low-income wage earner. It's during that five days that the wage earner may bounce checks and get into these bounce protection overdraft, this cascade of fees. It's during that five-day period that the low-income wage earner may go out and take out payday loans. So shaving just a day or two off those times could really make a difference.

MS. ANDERSON: Mark.

MR. METZ: Most of what I wanted to say has been said. Just a couple of comments. I agree with your comments on Check 21. I think that is improving things, and I think we will continue to see that. Our experience has been that the banks do cooperate pretty well on these things. And there is sort of almost like a fraternity among banks to try to get the bad guys. And when we do get these calls we do very much try to go out and catch them.

This is a complicated problem because the fraudsters become more and more sophisticated. Some we can call our bank and say, is this--did you issue this check. But we may not have payee information. We have a check in a series, and we know that the amount and the number, but we don't know if the payee has been altered; those problems. It's a hard thing to legislate because the fraudsters just keep--as we stop this, they come up with something new. I do believe it's simple, but the education piece is really important. To the extent the word gets out, be careful of cashier's checks, that I think would be the greatest thing to help.

MS. ANDERSON: Anyone else? Debbie?

MS. HICKOK: I believe that generally consumers view cashier's checks as a

trusted low-cost alternative to wiring funds. I think the general perception is that you take your money in, you purchase a cashier's check, that is a good funds model. So that is going to be a big education curve. When I think that if this is a problem that the financial institutions are dealing with in terms of what it's doing to their customer relationships for those customers that are bringing those in, I think this is a problem that the industry can solve itself, in that the issuing bank and the bank that is actually taking the deposit, if they participated with each other in providing information in a centralized database, that verification can be done on the front end rather than through positive pay systems on the back end. I think that would do a lot to solve it. So if somebody is bringing a cashier's check in, if you are able to go into a centralized database to verify that that is indeed issued by a valid bank, then I think that would do a lot to help the problem.

MS. ANDERSON: Luz?

MR. URRUTIA: Following on to that if a bank chooses not to participate then the depositing bank can place a hold that is longer than giving next-day credit. So as Mike was saying, there has to be some onus placed on banks that choose not to participate in a more sophisticated payment and risk-management systems.

MS. ANDERSON: I would just like to add usually a lot of financial institutions know their customer. I mean that's really why you should know them to find out, is it common for them to deposit a $10,000 cashier's check. But I also need to stress that from the teller's point of view, they are busy with operations. And because the checks look so good and they feel pressure from that line, it is difficult. But I know we have to also do a lot of education in house, which we are trying to do, but it is a big issue.

MS. ANDERSON: Anyone else? Anna?

MS. RENTSCHLER: I want to respond to Carolyn's comment about shortening the hold periods. I don't disagree that if the study shows that they have substantially reduced it, but I'm finding in our market, and I believe it's across the country, that most banks do not automatically hold deposits, we are using the case-by-case issue, and it's just once in a blue moon that we do hold them. So it's not an ongoing day by day issue.

MS. ANDERSON: And really for customer service a lot of us always try to give almost immediate availability, much to the chagrin of compliance officers, but we do try to satisfy our customers. Are there any other comments? Thank you for your time.

MS. SODEIKA: Thank you, Faith, and everyone. Now it's time for our Member's Forum.

MEMBERS FORUM

MS. SODEIKA: As many of you know, during each of our meetings, we have the privilege of hearing from council members on programs and initiatives at their organizations. Today Marva Williams and Sarah Ludwig will be providing us with a brief presentation, and as you guys are getting prepared, I have a brief description of each of you here.

Marva Williams is the senior vice president of the Woodstock Institute, a community lending research and consulting organization engaged in applied research, policy development and technical assistance to promote community economic development. She advocates for the needs of lower-income individuals and communities, and how the financial services industry can responsibly meet the needs of these groups.

Sarah Ludwig is founder and Executive Director of the Neighborhood Economic Development Advocacy Project, whose mission is to promote community economic justice and to eliminate discriminatory economic practices that harm communities, and perpetuate inequality and poverty. Sarah helps community groups develop local strategies to address redlining and lending discrimination, and conducts frequent training for groups and their members on consumer protection and fair lending laws; predatory mortgage lending and credit issues; and access to financial services in low-income and immigrant neighborhoods, and with that I'll hand it over to Sarah and Marva.

MS. WILLIAMS: Thank you very much. We're happy to be here today.

VOICE: Can't hear you.

MS. WILLIAMS: Is that better? No? Okay. Sarah and I are very happy to be here this afternoon to talk about our organizations and some of our collaborative efforts. So thank you for allowing us to participate in the Member's Forum. For those of you who are not familiar with the Woodstock Institute, we are a nonprofit organization. We were formed over 30 years ago. We are located in Chicago, and we work locally as well as nationally on high cost loan and the other financial service issues. We were initially an organization that advocated a great deal around the Community Reinvestment Act, and since that time we've developed programs to support community development financial institutions, and in the last several years we have been working a great deal on access to affordable services, and on efforts to curb

predatory home mortgage lending; refund anticipation loans; and payday loans and other forms of high cost credit. Sarah, do you want to talk about NEDAP?

MS. LUDWIG: Thanks. NEDAP was founded in 1995 as a resource and advocacy center to support neighborhood-based groups in New York City that were trying to get access to very badly needed financial services for affordable housing developments, small businesses, locally based financial institutions, et cetera. And the work really stems from our belief that everybody has a right to live in a safe, decent, thriving, healthy, sustainable community. So our work, we tackle really hard issues. As a resource center, groups come to us with what they are seeing in their neighborhood, and we have to find a way to help them tackle these hard issues. So we provide direct legal services, very extensive community outreach and education programs around consumer justice issues. We do fair housing work, fair lending work, corporate accountability, policy advocacy, and we convene the states' responsible lending coalition, New Yorkers For Responsible Lending, which has 130 civic organizations in it and community financial institutions. So it's sort of a hybrid organization that combines community economic development with civil rights and consumer advocacy.

MS. WILLIAMS: So one thing I want to say up front is that collaborations between community organizations I think are very common; that we often work together. In fact, Woodstock and NEDAP have been working together for many years on an informal basis to share information on banks, to share data on lending patterns, and to write joint regulatory letters and comment letters. However, about a year ago we decided we wanted to strengthen our collaboration, and in fact, began to develop collaborations with other organizations as well.

If you want to go to the next slide.

Some of the reasons that we decided to strengthen our collaboration was the need to share strategic information. Many of us had met at NCRC meetings and at other community convenings, and began to realize that we were working on many of the same issues, and that it was really important for us to talk about strategy development. You know the kinds of strategies that we utilized 20 or 30 years ago may not be the best strategies in this new market.

It also increases our capacity to work on a regional level and on a national level. Many of the issues that we’re concerned about are regulated at the national level, and then there are also regional trends that are similar across our community organizations. We are

also concerned about neighborhood impact, and that's something that often doesn't get much discussion--exactly how are some of these lending patterns, and financial service products, how do they impact total communities in New York and Chicago and elsewhere?

And then last it was--we are very concerned about the disparate impacts and discriminatory impacts of high cost loans. And to begin to identify policy advocacy alternatives was really a key reason for our collaboration. So, in our collaboration we decided initially to concentrate on two issues. The first is short-term credit abuses, and primarily refund anticipation loans, although both of our organizations are working on payday loan advocacy too. And then Sarah is going to talk about our most recent project, which is a multistate analysis of high cost lending using 2005 HMDA data.

So we chose to work on refund anticipation loans last fall, and it was a very timely decision for us. The fall is when Jackson Hewitt and H&R Block begin to gear up their advertising for refund anticipation loans. For those of you who are not familiar with them, RALs are short-term loans that are offered by tax preparers, and they basically allow people access to their own money, so they are borrowing their own money. And the advantage is, they get it eight to ten days sooner than they would if they received their refund in an account.

They are very high cost products. In terms of community impact, in Chicago in 2003 or 2005 there were 200,000 taxpayers that actually took out RALs, and the community impact of that is about $57 million. And as you can see in New York City the community impact is even worse. The APRs are often double-digit or triple-digit APRs, and they target people who are strapped for cash. Most of the people who receive refund anticipation loans are participants in the earned income tax credit program, so these are low-income people with children who are working families. And in fact the EITC program is actually this country's largest antipoverty program. And so it pains us to see the benefits of this program actually going to financial institutions and to tax preparers.

And it also very much inhibits asset development potential of the earned income tax credit. Many of the organizations that we are working with have developed programs so that people can invest their tax refunds into savings accounts and IDAs, and to help build assets, and this money is being circumvented. In addition to that, there is also circumvention of state usury laws. In New York, unlike Illinois, there are strict limitations on interest rates. And because the banks that are involved in refund anticipation loans are national

banks--HSBC, JPMorgan Chase, and Santa Barbara Bank, they are able to usurp those local laws.

Equally troubling or even more troubling is the fact that refund anticipation loan marketing is actually being pushed up during the tax season. So for example Jackson Hewitt and H&R Block are now offering what they call holiday loans, and people can receive these loans as early as the first or second week in November. They are fairly small loans of about $500 or less. But it includes a $150 fee, which is a nonrefundable deposit, on tax preparation services. So what they are trying to do is to get into the market quicker, to penetrate this market, and to gain market share in terms of their tax preparation. And in addition to that there is something called pay stub RALs which are loans that are made to RAL borrowers even before they have their W-2. So their taxes are estimated based on the pay stub, and not on the actual refund anticipation.

We are also really concerned about the whole safety-and-soundness issue when it comes to refund anticipation loans. One of the hallmarks of a predatory loan is a loan that is purely asset-based, that is not in any way based on the borrower's ability to repay the loan, and that fits a payday loan, that is the profile of a predatory home mortgage loan, and that is also true for refund anticipation loans. At most what lenders will do is some sort of credit scoring. But there is very little assessment of the borrower's ability to repay.

And we are also concerned about the detrimental neighborhood impact and the disparate impact on neighborhoods. And this is a map that NEDAP put together for New York City. And the cross-hatched areas here are communities that are at least 50 percent black or Latino, and as you can see there is a real concentration of refund anticipation loans in minority communities, up to 20 percent or even greater use of refund anticipation loans in those communities. We are very concerned about this disparate impact. These refund anticipation loan lenders are targeting low-income and minority consumers.

Corporate responsibilities or consumer education is one of the first strategies that we developed as part of our campaign, and if you want to click on that. This is an example of one of the brochures that we put together which discusses some of the important consumer education materials, or information that we think is important for consumers in terms of the cost of refund anticipation loans, the availability of volunteer income tax preparation services, the advantages of direct deposit, and actually having a bank account that your funds could be

transferred to, as well as avoiding check cashers, which is an additional expense that many people incur.

We also engaged in a corporate accountability campaign. Last fall we made several requests to Jackson Hewitt for meetings, and received no response or an inadequate response. And so we convened in New Jersey, back in January, and actually held a protest in front of the Jackson Hewitt offices in Parsipanny, and you can see Sarah there just about in the middle.

And we think that these kinds of--actually holding these lenders accountable is really important. And working with the media we also held a press conference that day. And one of the things that we asked for as part of the campaign, you can see there that they are holding up a check, and so we asked Jackson Hewitt to return to our communities $74.5 million that they had stolen from our consumers through refund anticipation loans. It was a wonderful event. There were people, consumer advocates from New Jersey, from California, from New York, Illinois, and North Carolina present at this event. And we will be continuing these efforts as we continue.

Now back to our strategies. The last thing I wanted to talk about is policy reform. And both of our organizations have developed several research reports and policy reports on the extent of the refund anticipation loan program problem, and its impact on neighborhoods. And we have developed in states that have the EITC credit model legislation that would prohibit refund anticipation loans that are based on that credit, as well as federal legislation.

And then last, we've met with our friends at the OCC, because the banks that are actually making refund anticipation loans are national banks. And we would like them to exhibit the same sort of leadership that they exhibited with the payday loan problem, where they developed guidance that had sufficient consumer protections. And we'd like them to do the same thing for refund anticipation loans. So I will now turn things over to Sarah who will talk about our HMDA collaboration.

MS. LUDWIG: Thank you, Marva. Just to complete a little bit of the story about our visit to Jackson Hewitt in Parsipanny, New Jersey. You saw us all standing outside the headquarters. It was really cold. It was really, really cold, and we actually, because we hadn't heard back from them, just let them know we'd be coming to visit and have a chat. And I

know you will be very surprised to hear that they did not invite us in. So I don't know. It was an interesting event.

(Laughter)

Okay, so I'm going to talk about something which is hot off the presses, brand new, exciting new report that is coming out today, today. And it's a report called, “Paying More for the American Dream.” And it's an analysis of 2005 Home Mortgage Disclosure Act data done by six organizations across the country, looking at six cities, four of them very large cities, and two smaller cities, of sort of focusing on home purchase lending, conventional owner-occupied home purchase loans, and the pricing of them.

So this slide tells you what are the cities that we looked at. And we looked at Boston, Chicago, Los Angeles, and New York City--those were the large cities that I was referring to--as well as Charlotte and Rochester, and each of the groups listed there participated in the research. Again this is coming out today.

So the reason that we embarked on this study is, for some of the reasons that Marva described as the basis for our collaboration in the first place, which is really to see if the patterns that we were experiencing in our own local areas played out similarly across the country. So we wanted to see whether or not local trends were prevalent in other cities. We also were very interested in what the pricing data showed, and whether or not there were connections, as we've learned from the Federal Reserve, that exist between borrowers' race and the pricing of home purchase loans. And we also wanted to identify lenders that we might want to be sitting down with to talk about practices, lending practices, and ways to make sure that neighborhoods and individuals are being served equitably.

So what we found looking across the board was that in all six of these cities, borrowers of color are much more likely to receive higher cost home purchase loans than white borrowers. This is information we already know, right? I mean this is not news. It's not earth-shattering. African-American borrowers in these six cities are 3.8 times more likely to receive higher cost home purchase loans, and Latino borrowers are 3.6 times more likely.

I think where our information, or our interpretation, of this data goes is somewhat different from the Federal Reserve's approach to this, and I'll talk about that in a moment. I mean the findings are broadly similar, but--well, I'll talk about it now.

In New York for example, the state attorney general was investigating the

mortgage loan pricing by a number of companies that did business in New York that had both prime and subprime channels, and wanted to understand, was there disparate pricing going on, and if so, what's the information behind the HMDA data that they could provide to document a reasonable or permissible legitimate basis for charging people of color more than their white counterparts. And that is all caught up, as some of you might know, in some litigation, between the Office of the Comptroller of the Currency and the state--it's the Office of the State Attorney General, because it was Eliot Spitzer. And there was one company however that voluntarily cooperated with the state attorney general's office, and that was Countrywide.

And there was a settlement just a few weeks ago between Countrywide and the state attorney general's office. Because even though the disparity in pricing was relatively low based on the HMDA data, for Countrywide, once it stepped forward and shared information about credit scores, loan to value ratios, the kind of indices that generally are pointed to as the basis for this disparate pricing, actually it didn't really hold water, and they ended up entering into a settlement. So we are very concerned for the companies that didn't cooperate, the companies that have a much higher disparities, what's going on there.

So we actually looked at seven of the largest lending institutions in these six cities, actually across seven of the largest institutions in the country, and identified those that had significant volume of higher price of prime loans, as well as those that had a significant volume of lower cost prime loans. And we found that the numbers really jump at that point--that African-American borrowers are six times more likely to have a higher cost loan than white borrowers; Latino borrowers, 4.8 times more likely. And that the highest black-to-white and Latino-to-white disparities were found with these companies: Countrywide, Citigroup, HSBC, JP Morgan Chase, Washington Mutual, and Wells Fargo.

So we wanted to scratch a little bit beneath the surface there, or delve more deeply. And we decided to take a case example of one lending institution, and that was Washington Mutual. And we wanted to look at a holding company that had a big subprime operation as well as prime. So we looked at Washington Mutual Bank and we compared it to Long Beach. And in this case study what we found, we'll just give you some facts and figures, Washington Mutual Bank, the prime arm, is the source of 80 percent of the white borrowers in Washington Mutual's lending pool. One percent of Washington Mutual Bank's loans are higher cost loans. Let's look at Long Beach. Ninety percent of Long Beach's loans are higher cost

loans. Seventy-six percent of Washington Mutual's loans to African-Americans were made by Long Beach, and 65 percent of Washington Mutual's loans were made to Latino borrowers through Long Beach.

Okay, so let's see what that means in New York. Here's a map of Long Beach mortgage lending in New York City. You might if you were looking at the last map recognize this sort of butterfly effect that we have between Brooklyn and Queens and even in parts of the Bronx. These are predominantly nonwhite neighborhoods, where people are getting in through the Long Beach channel and not through the prime bank.

Okay. I mean, clearly we believe that there needs to be suitability of mortgages vis-à-vis the borrower, and I know that word sends tremors through some people in this room. But the bottom line is, that we believe that lending institutions need to take some responsibility for ensuring that loans are priced adequately, and that they are affordable to borrowers at the time they are made. This chart shows the percentage of home purchase loans made by Long Beach by borrower's race for each of the six geographies. And without being able to see--well, you have copies of it, some of you--but we have Boston, Charlotte, Chicago, Los Angeles, and New York City; it's actually five of the six cities. We'll look at Chicago which is in the middle. The blue bar represents white borrowers to whom Long Beach made mortgages. The reddish purple bar which is 88 percent is to Black borrowers; and the yellow is to Latino borrowers at 83 percent. So we see that the lending channel, certainly in this case example, has very much to do with the pricing of the loan that the borrower receives, and certainly the door the borrower enters has really significant implications for how much that person is going to pay for the loan.

So I mean you know I was saying we were looking at lenders that have separate channels, because fundamentally we are very concerned about two tiers sort of bifurcated systems of lending that's going on, not just in the mortgage market, but that's what this study looks at, but generally speaking, that we have a two-tiered credit system based on race, and certainly based on race and income.

And this study bears out our understanding that borrowers in lower-income communities, that communities of color have unequal access to prime mortgages; that there are high foreclosure rates where subprime loans predominate, or where they have a strong presence or where they are prevalent. And we think this has really serious community development

implications, because for reasons we've talked about today, and many of us talk about all the time, is that this really--this sort of bifurcated lending diminishes community wealth in communities of color and lower-income communities. And mind you, I should have said this before, remember that butterfly effect in Queens and Brooklyn that I was showing? On the Queens side, which is the right part of the map, that is a predominantly black middle- and upper-income set of neighborhoods. So it's not just income in our city. It plays out very much according to race. We see people being displaced, and fundamentally economic opportunities hampered as people aren't able to avail themselves of equity in their homes for education, for needed repairs, for all the things that so many people take for granted.

So our organizations are looking to conduct future research. At NEDAP we are going to be looking at the data now in terms of the geography where the property is located, and I am thinking that we are going to have much more glaring information than we found when we looked at borrower race characteristics. It's going to be much more dramatic and distressing. And the report makes a number of recommendations, and you see them on the screen,--that we think that the disparities that we see warrant very rigorous fair lending investigation; there needs to be a stronger CRA lending test; where you see a high degree of subprime loans, you see an absence of prime loans. And we feel that the terrain needs to be established in which there is healthy competition among prime lenders, because we just don't see their presence in any adequate form.

We also believe, and this goes right to what the Federal Reserve also can do, is that there needs to be enhanced data disclosure in the HMDA data, and this is sort of an old cry here, but I'll say it again. Which is, that we believe we need to have information on the debt-to-income ratio, the credit score of the borrower, whether or not the loan was originated by a broker, what was the level of income documentation used to make the loan; and also, did I say loan-to-value ratios? And debt-to-income ratios? I'll just go in a circle and say it again. So we definitely need enhanced data disclosure, because we think that a lot of the research that is coming out of some places quickly explain away these race disparities, and we don't think that--we don't see it. We'd like that to be publicly disclosed, so that the public can look at this as well. And we believe there needs to be federal legislation around predatory lending, that is nonpreemptive, that also sets a national standard that is a good working standard to protect people, and that makes sure that loans are affordable and nondiscriminatory.

So Woodstock and NEDAP are certainly going to continue this collaboration. We didn't know when we first started that working together would yield so much, and we feel like we have been able to cover a lot of ground in less than a year, and we have a lot of great projects up our sleeves. So you will be hearing about them, and we look forward to answering any questions that you have. Thanks.

(Applause)

MS. SODEIKA: Thank you, Sarah and Marva, and thank you everyone for the discussion today. At this point we now adjourn this meeting, and we have lunch just down the hall. Oh, I'm sorry, I'm sorry. Hold on a minute, I missed the committee reports. Thank you so much, Sandy. We want to go around and talk about what we have on the agenda, or what we have discussed about having on the agenda for our upcoming June meeting. And maybe we can start with Stella on the Community Affairs and Housing Committee.

COMMITTEE REPORTS

MS. ADAMS: Thank you. We think that foreclosures and the housing market is still going to be an issue. One of the things we are going to focus on at the next meeting is servicing, and also, looking at NeighborWorks and other prevention mechanisms. So those are the things that we are going to concentrate on at our June meeting.

MS. SODEIKA: Mark and Faith for Depository and Delivery Systems?

MS. ANDERSON: We actually have a lot of items. We are going to be receiving an update on the Check 21 study that was mentioned today that is coming out in April. One topic we didn't get to was the uniform consumer protections. What we are doing is, we had the Fed list a chart, based on credit card, debit card, stored-value card. We are going to add Check 21 and ACH and we are showing what the consumer protections are for those various products. We are also going to hear the privacy comments on the model form as each of those comments should be in by then. We are also probably going to hear what the final rule is under FACT Act for the red flags guideline. And then other committee members recommended that we talk about Bank Secrecy Act from a point of view of limiting services to folks, and so I'm going to talk to my committee to see if we can also add that, too.

MS. SODEIKA: Thank you. And then Compliance and Community Reinvestment, Marva and Dorothy?

MS. WILLIAMS: At the meeting this month we talked about alternative

banking services for lower-income and unbanked consumers, how the Bank Secrecy Act impedes the development of outreach programs for underbanked consumers, and also, financial education. Since 2007 is the 30th anniversary of CRA, and so what we would like to do for the June and October meetings is to concentrate on community reinvestment issues. We would like to sort of go back to the basics and talk about the principles, the founding principles, of the Community Reinvestment Act, as well as to talk about potential ways to modernize CRA, and to expand its reach to other financial services.

MS. SODEIKA: Okay, thank you. And Kurt for the Consumer Credit Committee.

MR. EGGERT: We anticipate we'll be looking at Regulation Z both in open-end credit reviewing, initially, and also anticipate we'll be discussing with more specificity the closed-end review. We think that we will likely have another discussion of this guidance regarding subprime lending with an eye on reviewing the comments that have been received. We thought we would be discussing the credit scoring study that we anticipate we'll have. And also talk about a risk-based pricing proposal under the FACT Act.

MS. SODEIKA: Okay, full agendas. Before we go into lunch, we are all going to have our picture taken right in this area of the room. So if I can ask everyone, before we rush out down the hall, if we can gather right here for pictures, and thank you very much.

(Whereupon at 12:38 p.m. the proceeding in the above-entitled matter was adjourned)