TRANSCRIPT OF THE FEDERAL RESERVE SYSTEM CONSUMER ADVISORY COUNCIL

THURSDAY, MARCH 6, 2008

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., Tony Brown, Chair, presiding.

Members present:
Tony Brown, Chair
Edna Sawady, Vice Chair
Dorothy Bridges
Michael Calhoun
Alan Cameron
Jason Engel
Kathleen Engel
Joseph Falk
Louise Gissendaner
Greta Harris
Patricia Hasson
Thomas James
Lorenzo Littles
Sarah Ludwig
Mark Metz
Saurabh Narain
Ronald Phillips
Anna McDonald Rentschler
Kevin Rhein
Faith Arnold Schwartz
Edward Sivak
Shanna Smith
Cooke Sunoo
Jennifer Tescher
Stergios "Terry" Theologides
Linda Tinney
Luz Urrutia
Alan White

Others present:
Ben S. Bernanke, Chairman, Board of Governors
Randall S. Kroszner, Board of Governors
Frederic S. Mishkin, Board of Governors
Sandra Braunstein, Director, Division of Consumer and Community Affairs

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

9:05 a.m.

CHAIRMAN BROWN: Good morning, everyone. My name is Tony Brown, and I am the Chairman of the Consumer Advisory Council. Before we begin, I would like to take a minute to acknowledge the Governors that are here in attendance: to my right, Chairman Ben Bernanke, also Governor Randall Kroszner; and to my left, Governor Frederic Mishkin. Good morning.

On behalf of the Council, we would like to thank you for your time in joining us here this morning. I would also like to take a moment to welcome 10 new members of the Council whose terms began in January.

-- From North Carolina, representing the Center for Responsible Lending, Michael Calhoun.

-- From Boise, Idaho, representing the Idaho Credit Union League, Alan Cameron.

-- Kathleen Engel, from my state and representing Cleveland, Cleveland-Marshall College of Law, Cleveland, Ohio.

-- Greta Harris with the Local Initiatives Support Corporation from Richmond, Virginia.

-- Lorenzo Littles, Enterprise Community Partners from Dallas, Texas.

-- Saurabh Narain from the National Community Investment Fund based in Chicago, Illinois.

-- Ron Phillips, Coastal Enterprises from Maine.

-- Kevin Rhein from Wells Fargo Card Services based in Minneapolis, Minnesota.

-- Shanna Smith from the National Fair Housing Alliance here in Washington, D.C., and

-- Jennifer Tescher from the Center for Financial Services Innovation, also from Chicago.

Actually, we have a great meeting this morning as we focus on HOEPA and issues related to foreclosures. We will begin the meeting by discussing the Board's proposal to establish new regulatory protections for consumers in the residential mortgage market through changes to Regulation Z, which implements the Truth in Lending Act and the Home Ownership and Equity Protection Act.

The proposal addresses unfair, abusive, or deceptive lending and servicing practices, as well as mortgage advertising practices. It would also require creditors to provide consumers with transaction-specific cost disclosures earlier. Yesterday, members of the Community Affairs and Housing and the Consumer Credit committees discussed various issues related to the

Board's proposed rules. We will divide this discussion in two parts. Faith Schwartz, the chair of the Consumer Credit Committee, will discuss rules for higher-priced loans. We will then break, and then Ed Sivak, chair of the Community Affairs and Housing Committee, will discuss rules for all mortgage loans secured by a consumer's principal dwelling.

At this point, I would like to turn it over to Faith Schwartz.

MS. SCHWARTZ: Thank you, Tony. Good morning, Chairman Bernanke, Governor Kroszner, Governor Mishkin, and everyone else. The section that I'll be covering, as Tony noted, is on the proposed rule for the higher-priced loans. Those would be loans that are captured in the subprime market but exclude loans in the prime market for this coverage.

We are going to spend a little time on the definition of higher-priced loans, the ability to repay, the verification of income and assets, prepayment penalties, and escrow accounts. As we talk about this, it would be great if the people participating could note if they think the coverage should be broader into other segments of the market.

On the first area, we had a little bit of a discussion in our committee about the definition of the subprime, high-priced mortgage loans that are covered here because the coverage is quite different. I would like to start out and ask Mr. Metz if he has some comments.

MR. METZ: Thank you, Faith. Good morning. As a starting point, we support the approach that the Fed is taking in terms of looking at price rather than loan features in trying to define what is subprime. We also support covering subprime and excluding prime.

However, the way the current process works out creates a number of problems for us and, we believe, also unintended consequences. Really, two points on that. Number one, our view is that the definition is too broad. It covers too many loans and particularly, which I will give some brief examples on, much of the prime ARM and fixed market.

The second point is that because of the way the thresholds are determined for adjustable-rate loans, there is an unjustified, sort of harsh impact on prime loans -- excuse me, on adjustable loans with this process. I will acknowledge it's a difficult thing to give examples without handouts or things but bear with me.

A simple example. I went on Fannie Mae's website this past Tuesday. Published there are average mortgage rates for the country. The 30-year, fixed-rate loan as published on Tuesday is 6.24 percent. You could say that would be sort of for your average borrower. Other borrowers may have to pay a little bit more depending on the size of their down payment, if they

have credit insurance, APR, loan closing costs. So you could add as much as 75 basis points to that. Being conservative, say, you would only add 50 basis points to the 30-year fixed, so you would start with 6.24 and end up with 6.74, six and three-quarters, for the rate.

Then when you compare that with the Fed's process, which would use a 10-year Treasury maturity, which currently is at 3.53 percent. You add 300 basis points to that, and your higher-cost threshold is roughly 6.5. A 30-year fixed is above that as a starting point. So, again, our view is that it is a very broad net. Right now it's catching prime loans, which is not the intent.

It's more extreme when you look at the effect on ARM loans, again using the same data, simple data. The 3/1 ARM is advertised on Fannie Mae. Again, for averages, the 3/1 ARM rate is 5.11 percent.

Again, if you add 50 basis points to what a borrower may actually get, it's 5.6. When you look at the three-year Treasury, which would be the Treasury that would be used for a three-year adjustable ARM, the Treasury rate is 1.57. You add 300 basis points to that. That rate becomes 4.57. Again, that is the definition for higher-cost loans. In my example, the 3/1 ARM is at 5.6, so you are roughly 100 basis points over. Again, the simple point being that the net is too broad, and you're catching the prime market.

My company, Wachovia, is a very big prime lender. This is a big issue for us. We think by catching the prime market you are going to get two -- among others -- but two unintended consequences.

The first being that you may reduce prime credit. Many lenders -- again, I use my company as an example. We would not want to be considered a subprime lender. Similar to what happened when the HOEPA rules came out, many prime lenders tried to avoid making loans that were over the thresholds. You may have a similar situation here where people are pulling back on prime credit.

The other point is, in order to get your loan prices down, you may have to charge borrowers, or you will have to charge borrowers more up-front costs and fees, which will make it more expensive for folks to get in, another unintended consequence.

We have some suggestions, and it's really just dealing with the index and the spread. As a starting point, I acknowledge this is a very hard thing that we are trying to tackle here and solve for. Again, I commend the approach. I just think we need to take another look at the index and the spread.

The index, we would suggest, is using a mortgage rate index, possibly the Fannie Mae par rate. We acknowledge that may not be independent or as independent as Treasuries, but we think it's a better close or better proxy for what the mortgage market is.

We would also say, use the same index whether it's fixed or ARM. Don't match maturities as you do with ARMs. Finally, we would say on that to give the Fed flexibility to choose what index makes sense depending on particular market conditions. Maybe it is something you can evaluate every year or every six months.

Then, finally, and the point was really made by the example that I gave, the current spread, 300 basis points over Treasuries, doesn't work right now because it's capturing too much of the prime market.

We would advocate -- again using those same examples, if you use a proxy as subprime being 200 to 300 basis points above prime, we would advocate a spread of 500 basis points, again using that example I just gave. Thank you.

MS. BRAUNSTEIN: Can I ask Mark a question, Faith?

MS. SCHWARTZ: Yes.

MS. BRAUNSTEIN: I'm sorry. I just wanted to ask you -- you talked about one of your ideas was that we vary it and possibly depending on what's happening in the markets. Wouldn't that be confusing for compliance if we were using different thresholds every six months or every year?

MR. METZ: It would be difficult, but I guess my point was -- I was trying to say it would give you flexibility as to what index you use. Ideally, you would pick one and we would stay with that. I understand at different interest periods, different indexes may track more closely with the mortgage market than others. That was the suggestion there.

MS. SCHWARTZ: Joe.

MR. FALK: Yeah, I support what Mark is saying because, as another example, both Fannie Mae and Freddie Mac are about to implement new pricing methodologies.

The new pricing methodologies are a more extreme, credit score-driven pricing model where it used to be that 620 and above was prime pricing, but now 700 and above would be prime pricing with increasing interest costs or delivery fees up to 200 or 300 basis points for loans as the credit score goes from 700 to 680 to 660 to 640 to 620.

You could have someone who used to be at prime credit at 625 credit score,

which now would cost significantly more because of that pricing differential that is being introduced. Secondly, the reduction in LTVs on declining markets has a significant effect. Lastly, mortgage guarantee insurance premiums are going up on a relative basis.

So, by using the old methodology, which was okay in a very fluid market, comparing to T-bills, the components of the APR, which includes more than just interest rate -- it's delivery fees, it's lender cost, it's mortgage guarantee insurance -- all of those new, increased costs make that T-bill a less robust, shall we say, indicator of where the spread should be.

MS. SCHWARTZ: Time for one more.

MR. RHEIN: Thank you, Faith. In addition to the discussion around the index, we believe there are certain categories of loans you can just completely eliminate from the definition, such as nonconforming based on size. If somebody is taking out a large jumbo loan, chances are they are a much more sophisticated borrower and really don't need the protections that this particular regulation would imply.

Then also many of the other government-guaranteed loans that are already out there, FHA, VA, many of those already have protections for the borrower in there, so let's narrow the focus of the regulation to those customers that really need it the most.

MS. SCHWARTZ: Okay. Last question. Kathleen.

MS. ENGEL: I think that all of these points are good. The problem with --

CHAIRMAN BROWN: Speak into the mic, please.

MS. ENGEL: All of these comments, I think, are really good, and what they are highlighting is the fact that whatever trigger the Fed decides to use is going to be at times under-inclusive and at times over-inclusive. I think that is just the nature of the beast because it's impossible to incorporate all the different changes in the market into these triggers.

I think we are at a different point today than we were 10 years ago because what we've learned in the last year and a half is that there are tremendous externalities that are imposed on this society and on people who weren't even parties to these contracts and that we should probably be thinking of erring on the side of being over-inclusive at this point because of those costs rather than erring on the side of being under-inclusive.

MS. SCHWARTZ: Thank you. The next area that we discussed was on the repayment ability. Under the proposed agreement, creditors would be prohibited from engaging in a pattern or practice of lending based on collateral without regard to the consumer's ability to repay.

Rebuttable presumptions if the creditor failed to underwrite at the fully indexed rate or start rate, if higher; ability to make fully amortizing payments to include escrows; debt-to-income consideration; and residual income after debt with a safe harbor of seven years. We had lots of discussion on this. I would like to look to maybe Alan on the ability to repay. Or Mike Calhoun had a few thoughts yesterday as well.

MR. CALHOUN: Let me jump in while you're gathering your thoughts there.

MS. SCHWARTZ: I'm sorry.

CHAIRMAN BROWN: I've never known Alan to hesitate jumping in.

MR. CALHOUN: This might be a once-in-a-lifetime opportunity. I think a couple of sort of big picture concerns we have about the ability to repay are how does it relate and does it inadvertently undercut the joint agency guidance on ability to repay, which in many respects is broader.

Then, stepping back one level further, what is the impact of that on the relative closeness of regulation of federally regulated lenders versus state-chartered lenders. To cut to the chase, our fear is that, as drafted, we could have inadvertent negative effects on both levels.

First, by having more narrow ability to repay standards in the HOEPA rules, it can undercut the agency guidance. Second, we can end up with a situation that I think led us to a lot of the problems now of having state-chartered institutions perhaps less carefully regulated than federally chartered and regulated institutions.

Your federally regulated institutions will be subject to both the HOEPA regulations and the joint guidance and to your careful supervision and continuing future guidance, whereas the state-chartered will be subject to HOEPA and those states that have adopted versions of the joint guidance -- they will be subject to that but, I think everyone agrees, far less closely supervised.

Our view is that a lot of the problems of the last several years were pulling lending down to the least desirable lending practices. If you allow loosely regulated lenders to offer sort of wild products, it's very hard to compete against those.

It's like a football game where one side obeys the holding rule and the other has no holding rule. It's going to distort the outcome in an undesirable way. So we would urge that there be caution in looking for those unintended consequences.

MR. WHITE: Thanks, Faith. Sorry. I was still thinking about coverage and we

moved right along. I had two points about the repayment ability provisions. One is the inclusion of the pattern and practice requirement, which is kind of a way of trying to have your cake and eat it too.

There is obviously a dilemma in trying to set standards for the industry that are kind of not very specifically defined and the concern about the possibility of litigation.

I think that is really what underlies the pattern and practice requirement -- the notion that if you don't have that, every individual mortgage case will be subject to litigation about the repayment ability determination.

I actually had some experience litigating a case under the HOEPA standard, which requires proof of a pattern and practice, a case that we brought and tried for six days and then lost ultimately with a very thoughtful judge who was completely persuaded that the lender involved in that case, a lender that filed bankruptcy the following year, was making loans without regard to repayment ability in the instances we demonstrated, but was not willing to find that there had been a pattern and practice.

I know of one other case that the Justice Department and FTC brought against Delta Funding, which was settled with a settlement that was riddled with so many loopholes that Delta was able to continue making loans without regard to repayment ability until they filed bankruptcy recently within the last six months or so.

As it existed under the HOEPA provision, the pattern and practice requirement really prevented enforcement, I think, both by private civil litigants and by government agencies of that repayment ability requirement. I think you have to decide either to impose the requirement or not.

Otherwise, to have some really clear language that sets a very low threshold for what a pattern and practice is because as it exists under current law, it's a standard that really has no impact and is not enforceable. I understand the idea that bank examiners can enforce that requirement. The difficulty is that there are a lot of financial institutions making these loans that made them in the past and will make them in the future who are not examined by bank examiners.

The second point I had about the repayment ability requirement is this notion of having safe harbors for certain kinds of repayment ability measures. What we've had in terms of really well-thought-out residential mortgage underwriting standards in the past has been the work that's been done by the GSEs and FHA. Those are entities that have skin in the game. If they mess

up their underwriting standards, they get hurt financially pretty directly.

The FHA insurance fund gets audited every year for its solvency, so if they are setting their debt-to-income ratios too high or if they don't have adequate residual-income standards, then that's going to come out in the annual report that they are eroding the insurance fund, which has been self-funding. FHA has never required taxpayers to bail it out. The premiums FHA has charged for risk have been very small, 25 basis points typically.

So then the subprime market came along and came up with these wildly different repayment ability standards. Instead of having compensating risk factors, they layered the risk on top of itself. So instead of the 43 percent debt ratio we saw at FHA, we had 50 and 55 percent and 60 percent debt-to-income ratios. You can say the same about every other quantitative underwriting standard for repayment ability.

I would really urge the Board not to adopt any specific, measurable underwriting standard for repayment ability that goes beyond what had been the practice with FHA and the government-sponsored enterprises. To my mind, if you want to create a safe harbor, that should be the safe harbor.

If a lender is going to follow the underwriting standards of the government-sponsored enterprises or FHA, they are fine. They are safe. If they are going to push the envelope, then they need to have validated empirical evidence that they can do that and still have acceptable default rates and acceptable default rates in different economic environments. Right?

We had acceptable default rates, I suppose, in the subprime market when everything was working in a benign -- when we had this ideal economic environment for subprime lending. I think the way to do a safe harbor for repayment ability is to say, if you are doing what FHA permits, you're fine.

If you are going beyond those kinds of debt ratios and residual incomes and all the rest of it, then you as a lender need to document that you can project reasonably acceptable default rates doing what you are planning on doing.

MS. SCHWARTZ: Thank you, Alan. Ed.

MR. SIVAK: Thanks. Alan said a lot of what I was going to say about pattern and practice. I guess I just look at it from the standpoint of someone who had, in fact, gotten a bad loan -- someone who didn't know what they were being sold.

CHAIRMAN BROWN: Ed, speak into the mic, please.

MR. SIVAK: Someone who didn't know what, in fact, they were being given, or were deceived, and that having to put the onus of establishing a pattern and practice on that person is a nearly impossible task for that person to do to actually get out of and rectify the situation. I think that the ability to repay standards are great so long as that pattern and practice language beforehand is removed.

I know that obviously the rebuttals will be, we will have rampant litigation; there is going to be a chilling effect on the lending community. I actually think the specter of that is a good way to encourage the market to enact good underwriting standards.

MS. SCHWARTZ: Any other thoughts? Joe.

MR. FALK: I will take the other side of the debate. Unfortunately, I wish there were more lenders that were on this panel so I didn't have to talk so much.

CHAIRMAN BROWN: Mortgage lenders.

MR. FALK: Yeah, mortgage lenders, bankers, brokers, candlestick makers, whatever. The reality is that the folks I have talked to are, in fact, spooked by some of the proposals -- before full analysis, of course, and a final rule.

There are folks that are already looking at different business models and going out of their traditional lending patterns because of the threat of litigation and the increased costs that have to be passed along to consumers in the event that certain rules were put in place.

I think it's true that in the older days before, let's say, 2002 when the subprime market took on very different characteristics, in those old years, you know, you had the subprime world. You had fixed rates, fixed payments, and low LTVs. That was the characteristics of the subprime marketplace for people with damaged credit or, let's say, unprovable income ability.

What happened in the early 2000s up until last year before the markets froze is that we had a new type of subprime, which was 100 percent financing or variable rates or, as we say, the option ARM problem with hybrids. The very nature of those unique products layered onto high LTVs, layered onto no proven ability to repay, candidly created that mix of risk that created some of the problems you are seeing today.

One wonders whether, with lower loan-to-value ratios or fixed-rate, fixed-payment type of obligations, repayment -- so there is no payment shock, no ability for that payment to change -- whether there are some carve-outs for that type of lending that kind of makes sense in a more traditional model.

MS. SCHWARTZ: Two more. I think Cooke had a comment.

MR. SUNOO: Yeah. I was going to hesitate a little bit before jumping on a particular bandwagon because I've been on this bandwagon before. I know that Joe always speaks to kind of a narrow issue or point of perspective so I decided not to hesitate.

Specifically, the repayment ability is tied to proof of income, et cetera. Part of that et cetera is the requirement if you don't have your own income tax W-2 forms, that you have a third-party documentation of income.

Particularly, I look at the small business owner, the micro-business owners that deal in a cash economy. They don't report their income, and that is not good. It's an IRS issue, though. It shouldn't be a credit issue with them.

I would say the majority of the clients that we work with in Los Angeles that are small businesses have a significant piece of their income that is unreported, a majority of our clients.

Our clients are small business people, and our clients are, for the most part, immigrants. There is a kind of meeting of two cultures there, and both of them kind of don't report everything that they ought to be reporting.

If we require that they have third-party documentation of income, there is no documentation of income. What a number of lenders have looked at has been things such as, if you are a retailer, the amount that you are buying from Cash & Carry, Smart & Final grocery outlets that deal in cash.

So the small merchant who is buying his daily supplies can demonstrate that he has spent $200 a day or $500 a day, whatever, at the local Cash & Carry. It's called Cash & Carry because it's largely done in cash.

That would not be considered, I don't believe, as a third-party documentation of income. Having an evidence of income is a standard that I would say is perfectly acceptable and something that would then start to allow those that deal in a cash economy to be able to document their income to show evidence of income by backing into the situation.

It comes very close to what -- I think Ed had raised the point of the necessity of careful underwriting and that we can't create all of the regulations to cover every case. Really, the issue is underwriting.

An example of this is that a number of banks have started using the matricula card

as enough identification to do a home mortgage.

As of a couple of months ago, the mortgages that a matricula card is in lieu of -- the INS does not like the matricula card as a use of identification. It is a foreign country's ID card. It doesn't talk to the legal status, immigration status of the bearer of that card.

Yet, lenders have used that, and the evidence, the experience of mortgages made with the use of the matricula card have outperformed significantly the performance of our prime loan market.

Not because those with the matricula card are that much better across the board, but because the lenders have very carefully underwritten these loans because they know they are dealing with something that requires careful underwriting.

MS. SCHWARTZ: Thank you, Cooke. We have a few requests so I just wanted to note that Kevin had asked and Ronald and Kathleen and Tom.

MS. BRAUNSTEIN: Faith, I'm sorry.

MS. SCHWARTZ: Yes, sure.

MS. BRAUNSTEIN: I wanted to butt in one more time.

I'm sorry, Cooke. I just wanted to let you know that actually our intention was -- in the rules, the reason we wrote flexibility in third-party documentation for ability to repay was to cover just the kind of circumstances you just described, where somebody had receipts from purchases they had made. I remember at the last meeting you brought up the example of the dry cleaner who purchased so many hangers every month.

We remembered that when we were doing the rules. We were trying to cover exactly those situations. It is our intention that those kinds of things are covered as third-party documentation for ability to repay.

MR. SUNOO: That's good news because I keep reading documentation of income and an inventory of buying hangers doesn't for me --

MS. BRAUNSTEIN: That's good to know because we probably need to clarify that further.

MS. SCHWARTZ: Kevin.

MR. RHEIN: We do have some concerns with the pattern and practice, frankly, even though Alan wasn't successful in his suit and Ed has experienced some problems.

I think if you leave it in there, it's important to recognize that different adjudicating forums

have a different standard, and to the extent that requirement stays in there, to the extent the Board could provide some greater illustrations or clarity around what constitutes pattern and practice.

Some forums have had four, five, six, 10 loans out of 10,000 or 10 examples out of 10,000 constitutes a pattern. So what is that definition? We would just really suggest -- be as clear as possible so that we don't get into all sorts of different litigation activities when, in fact, there really was no intent overall.

MS. SCHWARTZ: Thank you. Ron and Anna.

MR. PHILLIPS: Go ahead.

MS. RENTSCHLER: I'll go ahead and speak up. I think that really what I wanted to address was what Alan said and then Cooke. I think that follows because in a community bank environment, a lot of the standards that are set by the government loans, and even the GSEs, although we do try to follow those, have to be a bit brought to the need of the borrowers.

The community bank serves a different niche than those huge banks that are throughout our country. Sometimes we have to, I don't want to say bend the rules, but just kind of mold them to the needs of the customer in a method, in good faith that we feel that they could repay.

MR. PHILLIPS: Thank you. I just might add to that the community banks are also on the ground and extend credit in somewhat of a neighborly way, but that also translates to, in our view, prudence and common sense in extending credit.

I just want to offer my support and fierce advocacy actually for the whole question of ability to repay and it executed in the best way possible because, in my view, and those of my peers and relationships I represent in the community investing world and in the CDFI world and with the families and lower-income families we work with -- principally in Maine, in my case, but all over the country -- the ability to repay has been at the epicenter of this whole issue of the meltdown of the subprime market in terms of the predatory aspects of that.

It's very hard to understand why we can't get to basic, prudent, and common-sense standards of credit. We do a lot of lending in my organization at Coastal Enterprises. We make a lot of judgments.

We are always looking at the question, does this pencil out for the family or the business and so forth, and we do take risks. There is a question here about not wanting to cut off credit because there is a way to manage that kind of risk.

But the lack of fiduciary accountability of the mortgage lenders, the mortgage

brokers and, to some extent then, how the banking system has aligned with that, has put so many families in peril I can't understand why just common-sense and prudent lending standards ought not to be the day.

We in Maine spent an inordinate amount of money, by the way. We are a nonprofit and we don't have a lot of money, but we spent hundreds of thousands of dollars, in fact, over a two-year period to get a law on the books in the state of Maine, at center of which was the ability to repay, to get at the state -- not so much the banks but the mortgage lenders and the brokers.

The banks are very concerned about it because of the liabilities around what that all means and how it's executed. I know it's a problem. But I just think you're in the right place to keep focused on the ability to repay and get some specific standards into the regulatory environment. Thank you.

MS. SCHWARTZ: Thank you. We have time for just a few more. I think Kathleen, Tom, and Tony wanted to wrap it up.

MS. ENGEL: I'll be quick. I understand the concern about the ability to repay provision and why some people would think that putting in a pattern and practice requirement might help.

The concern obviously being that there would be a threat of litigation and response that lenders would make fewer of these loans in jurisdictions or throughout the country if it were a HOEPA rule. Thankfully we have states who are doing a really good job serving as laboratories for all of us.

Last night, when I guess everybody else was watching CNN, I sat down with some data, and I looked at three states that have ability to repay provisions without any pattern or practice language. They have triggers that are lower than HOEPA so broader coverage than HOEPA.

None of them had any language about pattern and practice modifying the ability to repay. I looked at what their subprime originations were relative to prime after passage of the laws, and the originations actually went up.

So, the concern that the ability to repay standard without a pattern and practice qualifier could lead to a reduction in credit and high risk of litigation certainly has not been reflected in the marketplace. I think it is safe to take out that pattern and practice language. It would both

help consumers and, I think, also address some of Kevin's concerns about exactly what those words mean.

MS. SCHWARTZ: Tom.

MR. JAMES: I guess my concern on the ability to repay, first of all. I think that a cause of action based on ability to repay is usually going to arise in a situation where the lender and the borrower have failed to reach an agreement where the borrower is actually capable of repaying.

It is usually raised as an affirmative defense to actions brought by the lender. It usually indicates failure on the part of the underwriting of the lender or some changed circumstances on the part of the person.

If it's a changed circumstance on the part of the person, the judge is going to recognize that right away and know that they don't have a cause of action for abusive lending. If it's not their fault or if it's not attributable to some kind of change in circumstance but there was an abuse, I have a big problem with pattern and practice because what it effectively does for us, in law enforcement, is it kills the canary in the mine because the individual can't raise the one-off situation where they have been abused. The likelihood of us hearing about the pattern and practice is enormously diminished. It's a double-edged sword. The pattern and practice is very useful if, in fact, the individual who has found themselves abused by a lender can make the case and find other people in the same situation and bring the claim. It's very destructive in terms of a poor individual's ability to raise an affirmative defense when they really have been abused by a lender.

CHAIRMAN BROWN: Faith, from the committee's discussion is there a general recommendation or is the committee saying that the Board should give additional guidance on the pattern and practice element, or was there consensus as to whether or not that language ought to be eliminated?

MS. SCHWARTZ: I'm not sure there was a consensus across the room. Mark or Kevin or Joe, do you have any thoughts on that?

MS. LUDWIG: This isn't going to the consensus. I apologize for that. Very quickly, I would urge you to consider extending the repayment ability provision to nontraditional mortgages for all the reasons that Ron outlined.

Really, the unaffordability issue is at the core of so many of the problems that we are seeing. The 400th client, one who comes with a nontraditional mortgage that was clearly,

patently unaffordable and the broker knew and the lender knew and ultimately one would suggest that Wall Street effectively knew. It's just a travesty. This is still, you know, a huge concern notwithstanding changes in the market since the crisis emerged in its present form.

CHAIRMAN BROWN: So, no consensus on the pattern and practice language. How about any consensus on a bright-line presumption of a violation, whether or not a 50 percent debt-to-income ratio gave anyone levels of support?

MS. SCHWARTZ: I think there was a little bit of concern of that cutoff in the variability. Sometimes it might be that 51 percent does work in some instances, but often you want to see below. If you do a bright line, you might see a lot of things creeping up to it. Alan had some thoughts on that.

MR. WHITE: Let me just say this 50 percent thing came out of thin air. When we deposed the United Companies Lending's head of underwriting about where they got -- they were using 55. Fifty percent has just become kind of this folk wisdom in the subprime industry. There is no empirical study or validation of how loans perform in that margin.

FHA is at 43 percent right now, and I think there are some politics in pushing that up as high as it's gone. They actually have done research, and they have tested through economic cycles what different debt ratios will do in terms of cohort foreclosure and default rates over a long period of time.

Nobody has tested this 50 percent number. It's just folk wisdom in the subprime industry. You could say 47 or you could say 62. It would have just as much validity. Fifty is a round number. That's about all you can say about it. To put that in this regulation, I think, would be a complete travesty.

MS. SCHWARTZ: Travesty. Any other travesties on the 50 percent? I think the flexibility needs to be there a little bit, so I would concur.

Tom.

MR. JAMES: I was looking at that last night, and I wasn't going with travesty, but I was confused about why that is a trigger and how that plays into the transaction.

Really, my mind kept going back to loan to value. I don't know if there really is a usefulness for, say, prepayment penalties, given the way that’s shaken out in the market. But when I looked at this problem, I thought, it's more a problem of LTV.

MS. SCHWARTZ: Actually, that's a great point, Tom. I mean, people often

want a little higher LTV, especially if it's cash-out, and that's what pushes the debt to income up.

So, what you've seen in the GSEs over the years is limits on what that LTV is in different scenarios with cash-outs. I think that private-label market through significant cash-outs expanded significantly based on what the restrictions were in the more standard markets.

We have time for one more.

MR. WHITE: Thanks, Faith. I appreciate it. I think part of what happened in the subprime world with cash flow and debt-to-income ratio is what happened with the savings and loans and their payment reserves. They would make you a loan, and then lend you money to make the payments for the first six months.

In effect, that's what cash-out refinancings in the subprime world did. People would borrow enough money to make the mortgage payments or, if they weren't making the mortgage payments, they were using the cash to pay their other bills to reduce the stress on their cash flow so they could pay the mortgage payments.

You are not really testing people's ability to pay 50 percent of their income to service their mortgage in an environment where they are continually borrowing more cash on a one- or two-year cycle. For a lot of reasons, I think it has been very artificial to say that people can afford to pay 50 percent of their income in the low- and moderate-income ranges for a mortgage payment.

MS. SCHWARTZ: Okay. We have a few other things to cover here. On a very related issue is verification of income and assets. Through the Fed-proposed rule, it requires creditors to verify income and assets they rely on to make credit decisions.

Creditors would have the flexibility to use the third-party documentation that's reasonably reliable of income and assets. That could be in the form of tax returns, W-2, and other sources. We had a few comments and, again, they are related to the ability to repay as well.

Jennifer.

MS. TESCHER: I'll build on what Cooke said. I think Cooke did a good job of talking about this point. Often in these regs, the list of examples, if you will, of what is acceptable becomes the default standard, and so I would encourage in the writing to be as expansive as possible in the list of examples — frankly, to stretch the creativity of lenders and give sort of a signal of comfort, if you will.

Both from the entrepreneurial, small business side, how do I document, but also from an individual's perspective. The one thing I would just want to be really careful about is --

Cooke raised the matricula issue. That raises a whole series of other issues around BSA, AML, know your customer. Those standards, I think, are far more significant than the kind of standard you are suggesting here as it relates to verification as opposed to things like authentication.

That really starts to worry lenders and will have the exact opposite effect of what you are trying to do. In general, I think flexibility is the right way to go and just simply providing an expansive list of examples, I think, would be really important.

MS. SCHWARTZ: Do we have any other thoughts on this issue?

Mark.

MR. METZ: As a lender we would very much support that, the flexibility, because borrowers are different. Don't make it too prescriptive. Give us flexibility, and we would very much support that.

MS. BRAUNSTEIN: And we intended to leave that very flexible, like I said, but maybe we need to add some clarification around that.

MS. SCHWARTZ: All right. There are two more issues we discussed for this time frame. They are prepay penalties and escrows. We had a lot of discussion around prepay penalties. I have lots of people I can call on.

Through the rule, creditors would be allowed to use prepayment penalties with debt to incomes at less than 50 percent if the funds are used to pay the penalty not from refinancing from the creditor or the affiliate of the creditor; if the penalty does not exceed five years; and if the penalty expires 60 days prior to the first date of reset. There is a fair amount of robust discussion around prepay penalties.

Kathleen, I have some comments from you if you want to jump in.

MS. ENGEL: Well, I think my comments were that the best approach is to just eliminate the prepayment penalties altogether. Again, there has been work looking at various state laws that have abolished prepayment penalties altogether. It hasn't had a huge impact on credit.

When we are talking about borrowers who are locked into high-cost loans who could potentially move into lower-cost products but can't because of the prepayment penalties being in the way, we are actually reducing the resources of the very people whose resources we are trying to increase and assets we are trying to increase.

So it has a negative effect on the very people who most of the people around this table want to develop opportunities for asset building through homeownership and other wealth-

building initiatives.

MS. SCHWARTZ: Sarah is next.

MS. LUDWIG: We had a really interesting, engaged conversation yesterday about prepayment penalties. Although I would say we did not reach a consensus on them, there are quite a few people who agreed that a ban on prepayment penalties made a lot of sense for the covered loans.

Even the people who said, "I don't agree with the concept of a ban," there was, I think, a fair consensus that five years made no sense and that was way too long a period of time. We didn't really see the basis for that anywhere.

We also talked about how the marginal benefits to the borrower are so far outweighed by the problems created by prepayment penalties and the harms wrought. Then we also talked a little bit about something that we all know but I think we need to keep in mind, which is that prepayment penalties in the subprime market reach about 70 percent of the loans. In the prime market, it's less than 2 percent.

Not to be overly flip about it, but for me that kind of tells us everything we need to know about this product. And a ban doesn't seem like too radical a concept to level the playing field and ensure that people aren't trapped into these subprime loans, which seems antithetical to the rhetoric we hear about how they help people gain access to credit.

MS. SCHWARTZ: Thank you, Sarah.

Next, Mike Calhoun.

MR. CALHOUN: Thank you, Faith.

This is for us at the Center for Responsible Lending the most important issue before the Board on these regulations because of the key role that prepayment penalties have played in the subprime market in, I think, some surprising ways of undercutting the goals of these regulations.

As mentioned, they specifically reward and encourage steering and high yield spread premiums. Most importantly, they reduce competition and reduce integrity in this market because they not only lock in the borrower, they lock out responsible lenders who would offer a more appropriate product.

They also, I think, in a surprising way significantly undercut the ability to repay standards because prepayment penalties have been used in the subprime market as a way to fund the

loans not out of the monthly payments but out of the back-end fees. The data shows that the majority of subprime prepayment penalties are, in fact, collected. They are not just a deterrent.

Further evidence that shows that they don't make economic sense is Freddie's study which showed that subprime loans, not surprisingly, are far less sensitive to interest rate changes in affecting repayment speeds. In fact, they work out to be just a hidden fee.

You actually heard some of this when they raised it before. Lenders at one point when the lending was at its zenith were saying, "If we don't have the prepayment penalties, all these borrowers can't quality for the loan."

They use figures of as many as 25 percent couldn't qualify for the loan. What that was is they didn't have the debt to income. They did not have the income to service the loan out of their income. Instead, they were going to service the loan out of this back-end fee, the prepayment penalty.

I would note there is no limit in HOEPA as to the amount of the prepayment penalty. It's totally unlimited.

Furthermore, prepayment penalties are in no way counted in the fee trigger for HOEPA. The effect of all these together is to encourage what is one of the least transparent fees that have all these costs.

I finally note that the studies have shown -- we have done research that shows -- no benefit to borrowers when you took equally comparable borrowers and credit scores and loan terms and looked at the interest rate, whether or not there was a prepayment penalty. Borrowers actually had a higher interest rate for purchase loans and slightly lower, very marginally lower for refinance.

Even industry studies show that any interest rate benefit is far less than the actual dollar cost to the borrowers. Part of that is because this is not like the prime market where there is a well-known benchmark, so that I know right now that if I go in for a prime loan, I should get 6.25.

I can negotiate down the discount points or other terms to maybe improve that rate. We tried this out in our committee meeting yesterday, and I would say it probably works even in this broader audience.

Does anyone here know what the benchmark rate is for a 620 borrower, 50 percent debt ratio, and an 80 percent LTV? Can anybody even state with confidence within 100 basis points what that is today? Borrowers just aren't in a position to get the bargain, and evidence

shows they haven't.

Just, finally, there is a lot of good and a lot of important advances in these regulations. The prepayment penalty provision as written is actually a large step backwards. As mentioned, the five-year limit, even with the 60-day trigger before rate reset -- the standard subprime ARM loan now is a 5/25 so you are talking a four-year, 10-month prepayment penalty of unlimited amount.

There is the effect that we talked about in one direction that if you set a limit, anything above that there is fear that that is illegal and you set a guideline. We have seen clearly with state predatory lending laws that the other operation works.

If you say that prepayment penalties are unfair or abusive practices only when they are more than this five-year mark, you, in effect, legitimize all prepayment penalties below the five-year mark, which is completely out of step with existing best practices among lenders.

I would emphasize the point that was made by Sarah. I did not hear any strong industry opposition to saying, we can't live with a clear-cut ban on subprime prepayment penalties that would allow these loans to serve what they are purported to. It should serve as a transition for borrowers to move to better credit.

Particularly, the prepayment penalties should not be allowed to trap prime borrowers, which happens far too often, in subprime loans when they should be in a prime loan to start with. We would urge, as you may guess, a complete ban on subprime prepayment penalties.

MS. SCHWARTZ: Yeah, there might be some question on a complete consensus, but we'll talk about that.

Patty and then Mark, please.

MS. HASSON: I will be brief. I just wanted to say that even if you believe in a well-functioning market that the benefit is passed on to the consumer. I think all of the work that the Fed has been doing around financial education, around disclosures -- I don't think the average consumer has the wherewithal to understand what that benefit is.

The clients that we see in no way understood what they were getting into when they got prepayment penalties. But even if we could argue, okay, we could design a great education piece to explain it to them, I still think it would be like the two-month average balance on a credit card statement. They'll still never understand what they are getting into and what the net benefit is. For that reason, I think a ban is more appropriate.

MS. SCHWARTZ: Mark.

MR. METZ: It's a hard one to argue against parts of this, but I will. I agree there have been abuses with prepayments -- the 2/28s, the 3/27s that trap borrowers in bad loans, and then they have payment shock when they try to get out of that loan. That is a problem.

I guess I'll go back to my original point. What concerns me, though, is if you cover the prime market or part of the Alt A market with the regulations, you are going to, I think, drive up costs in those if you can't put prepayments in.

I don't have the data in front of me, but I will tell you that prime lenders do have prepayment penalties. We are one of them in certain products. I would argue, and I won't argue economics with the experts here, but it is, in part, an economic issue in that the way they should work is that you are going to get a lower rate with the prepay. They have to be well-disclosed.

I agree that there are problems that people don't understand. I think to just say, outright ban them -- I could probably live with that if we had a clear sort of subprime test. But because the current reg is so broad, that's what's causing us a problem.

An alternative or another way to think about this, if we do have these current triggers, is to really look at payment shock. I mean, that's the problem. You are trapping people, and then their rate goes up a lot.

An alternative I put out yesterday was, prohibit prepayment penalties where payments increase by a certain percentage, and we'd say 15 percent. If a payment goes up by more than 15 percent, you can't have a prepay. If it doesn't, if it's below that, a prepay is okay in that case.

MS. SCHWARTZ: Kathleen and then Alan.

MS. ENGEL: I'll be really quick. I think that prepayment risk is real, and it is something that lenders have to be taking into account. But if lenders really are indifferent to pricing that risk as part of the interest rate or as a prepayment penalty, then the question should be -- given this indifference, what is in the best interest of the majority of people, allowing the prepayment penalties or requiring that the prepayment risk be embedded in the interest rate?

If you take into account the fact that most borrowers don't understand prepayment penalties and that most of the borrowers who have prepayment penalties in their loans are the least financially sophisticated people, that argues for putting the prepayment risk in the interest rate and not in the form of a penalty.

MS. SCHWARTZ: We have a few folks. Alan.

MR. WHITE: I wanted to make a general comment about the preamble to this rule, which relates to the prepayment penalty issue. When I read the preamble, I was dismayed and disappointed again to see how tentative and cautious the language is about the real, measurable, empirically observed harms that have been caused by subprime lending.

The word "may," for example, is used, I think, 483 times in the reg, in the document. For example, prepayment penalties "may" cause harm to consumers. It has been demonstrated, and let me talk about the cost-benefit of prepayment penalties in the subprime market in a very concrete way.

So, the benefit. The only benefit that has been identified is presumably some kind of an interest break to the consumer, which has been empirically demonstrated not to occur. I think the best evidence that there is any break is something on the order of 10 basis points a year that consumers save by agreeing to a prepayment penalty.

What are the harms? First of all, the same borrowers who agree to a prepayment penalty are paying the penalty with a high rate of frequency -- probably 50 percent in the subprime market in 2006 and 2007. The penalties are typically on the order of 400 or 500 basis points.

So, you are making this bet: Maybe I'll save 10 basis points or maybe, best-case scenario, 50 basis points on the interest rate, and I have a 50-50 chance of paying a 500 basis point penalty in year two. I mean, if that is the bet the consumers are making, they are losing that bet every time -- well, half the time.

Just if you look at the incidence of the penalty and the supposed savings and you ignore all the other problematic aspects of prepayment penalties, they are not working out in the consumer's favor.

Secondly, the supposed benefit of this price break that consumers receive and the added liquidity and availability from lower rates is not happening because of rent-seeking. Basically, prepayment penalties are a way that savings at the wholesale level can get captured before it gets to the retail level.

The third problem, of course, is this lock-in effect that Michael has talked about and the barriers to competition and to refinancing. But there are two other important harms that I think have to be considered in looking at prepayment penalties in the subprime market.

The foreclosure effect. Prepayment penalties are significantly increasing foreclosures because what they are doing is creating this sort of breakup fee. If somebody wants to

sell their home, for example, and they are at 99 percent loan-to-value ratio, that 4 percent prepayment penalty is now putting them at 103 percent loan to value, and they can't sell their house or refinance it.

There is a study, I'm pretty sure -- I don't remember if it was CRL or the Center for Community Capitalism -- but there is a study showing a link between loans with prepayment penalties and an increased rate of foreclosure. That is not something you want to create is added foreclosure risk.

The last, and I think one that shouldn't be overlooked, is the equity effect. These prepayment penalties have been shown to have a disparate impact on minority borrowers, particularly African-American borrowers who were targeted for these kinds of products, and I don't know that there can be any assurance that that kind of steering is somehow going to cease, even though it's illegal.

When you add up all these demonstrated, empirically measurable harms that prepayment penalties have caused in the subprime market, and then you put on the other hand of the scale the benefit that nobody has really been able to demonstrate.

The only reason there seems to be any doubt about banning prepayment penalties is because of a theoretical vision of how this market ought to work that is divorced from the way the market actually has functioned for the last 10 years.

MS. SCHWARTZ: I might jump in on this one, and then we'll go around to a few more comments. A lot of what has been said is true, although I would say the capital markets did price prepayment penalties up to 100 basis points below those without, and that is a reality and that's from Wall Street.

Lenders often would pass that through on their rate sheets. That has been also evidenced. The problem is, as Alan and others have pointed out, it doesn't always accrue to the retail level, either on the retail side or on the broker side, and that's a fair comment.

I guess it seems to me if affordability, and whatever the markets look like as they resurrect -- the thought process should be, it's a tool in the market. Put strings around it or harness it to make sure it's two years max if there is a two-year ARM, 60 days prior to the expiration of the ARM. If that’s worth a 100 basis points lower rate and if there is a willingness and an understanding on a complex product which, as Patty noted, that's pretty hard to ever understand a prepay penalty, that’s a hard choice. You just eliminate tools from the market.

I'm not one to think you should eliminate the tools. Just put some rules around it. And even think about accruing the benefit right through to the borrower. There is no upsell on a yield spread premium. People are charging more because as a prepay it was passed through to get to the consumer, but it doesn't get to them. That is a fair argument and a problem with prepays. So I think there is a linkage to yield spread, and there is a way to limit that. So that's another thought for you on the prepays.

I think five years is far too long. I somehow don't remember us really getting back to the five year on that, so I have a memory loss on that one. Two years or anything commensurate with the ARM, but max it at three years on the fixed rate. I think it is a tool that has been used over the years, and I don't know that you should ban it.

Lorenzo.

MR. LITTLES: I was part of yesterday's robust discussion on this issue, and I'm glad to see that it has played out again. I think, without belaboring it, for the reasons given by Kathleen and Sarah and Michael and Alan that I would for my part strongly endorse a ban on the prepayment penalty.

MS. SCHWARTZ: We had a few others. Kevin.

MR. RHEIN: I would come on the other side. I think there is some role for it. I think it is a matter of choice. I think there can be a rate discount. I do agree five years is too long. In Wells Fargo, what we do is we have a 3-2-1 – so, 3 percent in the first year, 2 percent in the second year, 1 percent in the third year.

I think there can be constructs that are put together, and I just think an outright ban is eliminating some flexibility that pricing can benefit a consumer.

Clearly, there have been some abuses. I think these always have to be well-disclosed. But I would just encourage the Board not to do an outright ban, but to put some more definition and process around it, perhaps as we have done at Wells Fargo.

MS. SCHWARTZ: We have several more requests. Edward.

MR. SIVAK: Okay. I'm going to respond to a couple of comments that Mark made. First about the definition, and then the notion of trying to protect around payment shock.

I look at it through the context of Mississippi. In Mississippi, four out of 10 loans are high-cost loans. That is using the HMDA data. Unlike the coast in Florida and other parts of the country where you hear about these really high home prices, the median home value according to the

census data is $88,600. When you think of that home price and you think about the amount of subprime lending, it shows you, I think, really the effect on low-income communities.

Take that one step further for African-Americans. Seven out of 10 loans were high-cost in Mississippi, according to the HMDA data. Forty percent of our population is African-American, just about. When we talk about a definition of how we are going to talk about subprime lending, I think it needs to be broad so that we can protect folks who are in lower-income communities as well.

Then within the context of payment shock, somewhere along the line throughout the subprime lending crisis we moved from -- homeownership moved from a tool that was used to build wealth to just something that people used as an ATM.

If we are ever going to address the challenges of poverty in our country and in our communities, we need to have tools that are available for folks to build wealth. Poverty is not just about income. It's about presence or absence of assets.

I think -- after a lot of thinking, looking at research, talking to colleagues, and trying to find a middle ground on prepayment penalties, that tool doesn't help folks build wealth, especially low-income people.

Because of that and after much thought, I think we need to get rid of that tool and again get back to the notion of how do we use homeownership to build assets to really start attacking poverty in our country.

MS. SCHWARTZ: Thank you, Ed. I think we have Saurabh and then Tom and Terry.

MR. NARAIN: Thank you, Faith. Just a small preamble. I came from a very large bank working in the interest rate derivatives market and now working in a small institution working in low-income communities. The reason the preamble is -- in the interest rate derivatives market, we came up with a standard called “appropriateness” for people we are selling the product to.

Sometimes I get worried when we try to have a legislative fix on a market-space product. In that context, I get worried when we sort of ban a prepayment penalty. But in the context of the appropriateness standard, I would side with Kathleen in saying the markets have actually worked quite well.

The option-adjusted spreads have worked quite well in understanding what the

prepayment penalties could be and therefore have priced in in the interest rate. And therefore, in the overall context of appropriateness and the loss in wealth that we have seen in the subprime crisis, I would sort of side with the idea to ban prepayment penalties for some of these products.

MS. SCHWARTZ: Terry.

MR. THEOLOGIDES: I respect a lot of the opinions that have been shared. I think where I come down is similar to Faith and Kevin -- that I think many of the abuses and concerns can be regulated through limits on duration, limits on how they interrelate with payment adjustments, better disclosure, even limits on amount.

I do think it is a powerful tool that could be harnessed for affordability. I think while there have clearly been abuses, I'm concerned about dismissing it or abandoning it as a tool altogether. I think that the prepayment risk is real. It’s reflected in the secondary market. It's not the same for a lower-interest prime loan than it is for a higher-risk, higher-rate loan.

I would think that proceeding to contain the abuses through regulating the duration, you know, the amount, and disclosure would be the prudent way to go to preserve the ability for that tool to be harnessed in an appropriate way.

MS. SCHWARTZ: Tom.

MR. JAMES: I was listening to what Faith was saying. A lot of food for thought. One of the arguments for prepayment penalties is the increase in liquidity that theoretically they give because they give the industry the ability to price prepayment risk.

But I don't think that the other side of the equation is actually met on the consumer's same assessment of their ability to judge their prepayment risk. Unless you have both sides of the equation working at the same time, you get price distortion ultimately in the secondary market.

You get it initially when the consumer makes a choice -- an irrational choice -- not based on the risk that they are actually going to end up prepaying. I think that’s what we have at this point in the subprime market. I don't think we probably have it in the 2 percent or less of people in the prime market who made that particular risk assessment.

First of all, you've got to take the bet on whether the rate you're locking in is going to change. It's a bet you're taking with the bank. Then you've got to understand the bet that you're taking that you're not going to fall into that percentage of people who prepay.

That calculation is simply not happening by people who are buying these things at

retail, mostly because the benefits almost never have been passed through and so people don't even know that there is a risk calculation to be made.

That creates a price distortion that gets reflected in the entire system of securitization. I think it ends up making it completely impossible to price the risk at retail, which has caused most of the problem we're in.

CHAIRMAN BROWN: But on that point, Tom, are you saying then that there should be a prepayment penalty or are you disagreeing with Kathleen that it can't be priced?

MR. JAMES: The problem is, for sure -- I don't know the figures, but there is an argument to be made that it certainly worked or that it has been an okay bet at the tables in the prime market. It’s been a fixed bet at the tables in the subprime market.

It’s been very, very damaging to the economy's ability to price risk, all the way through from our pension funds’ ability to judge the appropriateness of giving money to the people in our neighborhoods.

The people who have to make the decisions based on their risk factors don't know the calculations, and they don't even have the information to know because the benefits haven't been passed through so they can make the decision in the first place, so they even have the information to make the decision.

CHAIRMAN BROWN: I wasn't briefed as chairman if I'm supposed to stay neutral.

MS. BRAUNSTEIN: No, you're fine.

CHAIRMAN BROWN: I guess I've been on this issue on several sides. I used to supervise a wholesale sales group who bought subprime loans at the time with Equicredit, and I was amazed at how brokers would price up if you were able to sell a prepayment penalty.

To me, it seemed like the benefit of the prepayment penalty inured to the broker who was selling the loan. So I lean toward what Kathleen and Saurabh said about -- I think that the investor will price prepayment risk, and they don't necessarily have to put it in as a specific penalty.

I also would think and wonder that the investment community is smart. Subprime lending has been around for decades and that there is probably some actuarial assumption about the speed to which loans could prepay and that the portfolio risk could be priced.

My position would be for the Board to consider eliminating prepayment penalties because I think the investment community has enough data that they could price it to risk.

MS. SCHWARTZ: We just have time for two more. How's that?

Michael.

MR. CALHOUN: I'll be very quick, and just three points that sort of echo your suggestion of, if you could make sure that any benefit passed through, and I would submit you can't. We saw this repeatedly with lenders in the subprime market.

When you contest that either phantom discount fees or prepayment penalties, their response would be simply, "I'm charging you 10 percent, but I would have charged you 11 percent without the prepayment penalty" -- even though other lenders would charge even less without the prepayment penalty.

There is not a mechanism to see or force the benefit down to the borrower. We have the same experience that you saw, Tony, that again and again the rate sheets even specifically tie the size of yield spread premiums to the presence of a prepayment penalty. If you want a larger yield spread premium, you have to have a significant prepayment penalty on the loan.

Second, again, for the expert economist here, it doesn't seem to make sense the disparity in prepayment frequency in the subprime and in the prime market. By definition, most subprime borrowers are paying a rate premium hopefully so they can soon improve their credit and move to a lower-cost loan.

And yet, however you measure it -- and the numbers vary some -- but they are fivefold or more as likely to have prepayment penalties on their loans. They are also, I think, fivefold or more as likely to have large yield spread premiums.

Lastly, and I think this may be the most important reason, the issue that has clouded the subprime market more than any other is the racial disparity and the steering in the market. Eliminating subprime prepayment penalties is far and away the most important step that can be taken to eliminate that steering because prepayment penalties are an essential element and a large financial incentive for that steering.

I would submit that if you want to eliminate steering and racial disparities from that market, rather than prohibit the end result, you have to change the incentives in the market. Right now, the prepayment penalty operates as the largest incentive and enabler of steering and racial disparities in the subprime market.

MS. HASSON: I will be very brief. The word “disclosure” has been used a couple of times now, too, by the lending community, and I just have to again emphasize that

disclosure with consumers in the low-wealth area will not work. They will not understand it, and you will be back here in a few years questioning because they will not understand disclosure.

If we're betting, I'll bet you two years from now they won't understand it. I think that has to be emphasized and taken into consideration, and all the testing they will not understand.

MS. SCHWARTZ: One more.

Edna.

MS. SAWADY: Thank you. Building on Patty's comments, a couple of my colleagues were talking about understanding the risk, being able to calculate the risk, being able to price the risk on the side of the consumer. Some of the remedies that have been suggested -- there is more education, more transparency in helping consumers do that, which brings us to a basic assumption -- that borrowers in this segment are rational decision makers who will know how to make decisions or even want to make decisions at the point of sale.

That has been shown time and again. I'm not suggesting that all decisions are irrational. Many rational decisions are followed by a lot of just emotional things that are going on at the point of sale.

Too many times we have seen transactions where borrowers are presented with a choice, "You can qualify now and worry about other things later or you can just not qualify." I guess I'm adding my support to the total ban of prepayment penalties.

MS. SCHWARTZ: One minute.

MR. PHILLIPS: Real quick. Thank you. Just to support the ban on prepayment penalties. We've had this discussion in our state legislature in the state of Maine, and many states have had this. They have adopted rules including banning prepayment penalties, which are one of the 10 commandments, really, of this whole issue of the egregious practices within the predatory aspects of the subprime market.

I just want to make that point that many states are already weighing in on this, and hopefully at the federal level and these kinds of regulations would reinforce those and not certainly be weaker than what the states are now facing and doing. Thank you.

MS. SCHWARTZ: Thank you, everyone. That was a good discussion on prepayment penalties.

The last issue we're covering is the escrow issue, where the Board has proposed a rule of mandatory escrows for those loans covered under the subprime, high-cost definition with an

opt-out after 12 months. We had some good discussions on that.

Anna.

MS. RENTSCHLER: From the community bank perspective, I can sit on both sides of this fence. As a former mortgage lender, I think that escrows are very important, especially in the subprime market. Many first-time homebuyers are really not aware of all the costs and the gyrations, whether the evaluation of the real estate, the insurance ramifications, flood, heaven forbid should they come in. So I am really for that. The 12-month opt-out I am not in favor of. I think that is far too short a period in a subprime situation because if that person then buys it at a certain time of the year, we might be escrowing for one and then, oops, they don't want to escrow anymore.

All of a sudden you're rolling into some type of situation where they don't pay the real estate taxes, insurance -- force placing and probably paying more for that. I think it's very important.

However, on the other side, since I'm here in a community bank environment, it is important to recognize that there are some smaller financial institutions that don't have the ability or the desire to escrow. This is a very costly endeavor, so I don't know where that puts the small banks other than, "Hey, just don't make these type of loans."

That's one possibility. Starting an escrow environment, doing the analysis every year, sending out the notices -- it's quite costly, so there needs to be some kind of give and take with regard to escrows. But by and large, I am absolutely for escrowing on subprime mortgages.

MS. SCHWARTZ: Any other comments on escrows?

I'm sorry. I apologize. Edna.

MS. SAWADY: I'm just reacting to Anna's comment. Community banks are doing great work in the communities they serve. On many other aspects, many of them tied to technology and to other services that require scale. I believe people know very well how to outsource, and there are many other areas where community banks do not take the responsibility of doing it themselves. There are other ways of getting around it.

MS. RENTSCHLER: In response to that, I agree that there are other ways to get around it, but then there is a cost and that is passed on to the borrower. I can fall on either side of that argument.

MS. SCHWARTZ: Kevin and then Joe.

MR. RHEIN: We totally agree we should absolutely have the escrow statements.

It's just a question of making sure there's enough time to change any systems that might be required. Not all of our different business units have that capability.

Even today we fully underwrite projecting what that payment is if we are not actually escrowing. Provided there is a reasonable period of time to get the systems worked on, we would fully support it.

MS. SCHWARTZ: What is a reasonable amount of time, Kevin?

MR. RHEIN: (Two days.) I don't know the answer.

MS. SCHWARTZ: Okay. Sorry.

MR. RHEIN: I would say at least 12 if not 24 months, I would think. Somewhere in that time frame.

MS. SCHWARTZ: Joe.

MR. FALK: A minor concern about the thousands and thousands of new mortgage lenders who will now certainly in the subprime space have no experience in escrows. The concern that I have is that while RESPA addresses segregation of funds, protection of those funds for consumers, one wonders if a better analysis of protecting consumers' funds would be in order.

We have one bankruptcy case currently where a judge has frozen the escrow funds so that we have this unusual situation. American Home Mortgage, I believe, is the specific site where escrow funds that were in good faith given to the servicer are now stuck in a bankruptcy situation by the lender.

My concern would be that any rules where you have thousands of new people collecting payments for escrows, taxes, and insurance in advance, that those funds be protected so that they are not subject to other claims.

MS. SCHWARTZ: We have time for maybe one more. Any further thoughts on escrows? I think it's a good thing in that if you are prudently underwriting you are already underwriting to the fully escrowed amount. So it shouldn't have a big impact either way, but more stability in the loans for the lenders and the borrowers.

GOVERNOR MISHKIN: Joe, I was a little surprised about this issue of bankruptcy. How often does this happen? I'm not a lawyer, but is there some kind of trust arrangement so that the escrow would be separated and could not go into this forum? I'm not a lawyer, but we have plenty of them in this room.

Maybe you can add a thought. I'm not sitting next to one; I am sitting next to

many. That's okay, my son is in law school. Maybe if you could clarify this because it is an issue here. But if it is actually something that is extremely rare or should be extremely rare, or maybe there is an issue about how that is dealt with, but not the issue of escrow itself.

MR. WHITE: I've had a little experience with being on a creditor's committee in a lender bankruptcy a couple of times. You're right, Governor, that those are trust funds that are not part of the bankruptcy estate and are not distributed to the lender's creditors.

But as a practical matter, the situation Joe describes does arise that there are bank accounts that nominally belong to this bankrupt mortgage company that do get temporarily frozen while things get sorted out.

But ordinarily, the homeowners' payments are going to be protected, and the tax payments will get made and the insurance payments will get made because the loans or the servicing rights are going to get transferred to some other entity after the bankruptcy.

Typically, a buyer is going to be very concerned that those escrow accounts be properly maintained. There can be hitches and inconvenience and possible delays in getting some of those tax and insurance payments made, but I think the bankruptcy system deals with that situation reasonably well. We are going to see a lot more mortgage company Chapter 11s, unfortunately.

MS. SCHWARTZ: Okay. I think one last question and then we're done.

MS. URRUTIA: Just in general, we talked about the consumer sometimes not understanding the products and services they are being sold. Sometimes the lenders themselves don't understand the products and services that they're selling.

I would just encourage this group to think about -- just like securities brokers have to be licensed to sell certain types of securities, that -- depending on the kind of products that these mortgage originators want to sell -- that there ought to be some level of certification based on ability, size, scope, capital, sophistication.

I think that would definitely help some of this problem going forward. The second part, and this might be a little bit more controversial, is for those entities that do want to engage in those higher-priced loans or those higher-risk loans -- that some level of participation where they have to keep a portion of that portfolio also be considered as part of this.

MS. SCHWARTZ: Thank you very much. Thank you, everyone. We are concluding the first part. We are ready for a break.

CHAIRMAN BROWN: I think what we'll do now -- we are going to take a break

but we are going to come back on this important topic. If you thought prepayment penalty was fun, wait until we talk about yield spread premiums. More to come. Come back, please, in 15 minutes. 15 minutes.

(Whereupon, at 10:33 a.m. off the record until 10:46 a.m.)

CHAIRMAN BROWN: We are going to continue our discussion on the Board's proposed rules for residential mortgage transactions by focusing on the rules for mortgage loans secured by a consumer's principal dwelling. Ed Sivak, chair of the Community Affairs and Housing Committee, will lead this part of the discussion.

Ed.

MR. SIVAK: Thanks, Tony. So we are going to be spending the next 45 minutes really trying to get through the remaining things that are in the final rule that's been published that is up for public comment. The first thing that we are going to be talking about is creditor payments to mortgage brokers, yield spread premiums. I anticipate that we will spend a little bit more time on this than the others because I think folks will have a lot to say, starting with Joe.

MR. FALK: It should come as no surprise that I'm speaking about mortgage broker compensation. My position, as in the prior meetings of this group, is very simple. I believe in equal disclosures for direct competitors -- that there should be no channel bias between folks that are ultimately presenting loan programs to consumers.

I would say to you that the originate-to-distribute model, which has clearly taken over the market in the last five to 10 years, is code for the fact that we are all just mortgage brokers because, ultimately, if you originate to distribute, you are acting in a mortgage broker capacity.

The original definition or the line in the sand between mortgage brokers and lenders was drawn back in 1992 under the RESPA ruling that ultimately was under a time and in an age that was very, very different than what we have today some 17, 16 years later.

I favor a disclosure of the role of the loan officer for every transaction -- prime, subprime, nonprime, whatever you call it. As a matter of fact, we have been proposing -- I have been proposing since 1998 such a disclosure to HUD under their RESPA rulemaking that the issue of the role of the originator should be clearly defined and the consumer should understand what their role is.

My concerns about the proposed rule are two, very simple. One, it should be all originators and not just mortgage brokers because different people acting should be treated the same.

Secondly, to include a dollar figure of the yield spread or the compensation to mortgage brokers only belies the reality of many, many forms of indirect payments that go to other brethren in the origination community that are not currently disclosed.

I said before at these meetings that consumers really don't know the difference between brokers, bankers, lenders, Internet folks. When they walk into two mortgage stores, there is generally no signage or no ability to determine which kind of entity they are walking into. I would say to you they shouldn't have to.

Secondly, people operate in the mortgage industry, originators operate in multiple capacities. I saw an internal memo with Countrywide Mortgage just this last week where they are now going to allow their retail originators, retail loan officers to act as mortgage brokers if they don't have an existing product line that would fit that individual consumer.

This is quite common. They are not the first one to do it. Many mortgage companies act in multiple capacities depending upon the product that is available at that given time.

So I'm not quite sure how you delineate between brokers, bankers, and lenders when an individual consumer could start out in a lending world, move to a broker-type transaction, and then move back again when the final underwriting and the final documentation is ultimately secured.

How you are going to navigate these changing roles is something that I think is unnecessary because all consumers deserve the same disclosures, the same roles, no matter. To the degree that there are individual mortgage companies, even lenders, who wish to adopt the [Jack] Guttentag model of a fixed fee, great.

Disclose the fixed fee and move on. But don't burden the rest of the market with a model that may or may not be appropriate for their locale and their community. My sense is that many people operate in many different capacities.

I would also say that the disclosures make a difference. Two examples. One, in RESPA rulemaking in 2004, the Federal Trade Commission did a landmark study based upon their proposed good faith estimate. What they found is that the proposal coming out of HUD did steer consumers into, on average, higher-priced mortgage loans because of the disparity of disclosures of yield spreads versus nondisclosure of other indirect payments from lenders.

That study is with staff. I think that the practical effect at that time was to

disadvantage small mortgage companies from their larger competitors.

Secondly, you should know that on the ground, in the offices these documents are used as sales tools. When a consumer shops between a mortgage broker business and a mortgage lender business, the loan officers point out the differences on the forms. "Ooh, don't pay that yield spread." But they conveniently forget to say, "I'm going to get an indirect payment called an SRP or a gain on sale when I originate to distribute."

I would also say that it's not just the SRP, and we've talked about this indirect payment on the originate-to-distribute model. It's also affiliated business arrangements. Back in 1992, under HUD's auspices, we created the ability to have affiliated business arrangements in this world of mortgage origination.

We have seen a lot of criticisms of that model. We have seen a great number of criticisms coming out of the title insurance industry, where it has been alleged that sham affiliated business arrangements were created by origination companies, including mortgage broker companies, only to increase prices and get more profitability.

Those payment streams are not disclosed. In the mortgage guarantee world, it is quite common for the large multistate lenders to have in-house mortgage guarantee companies where they might take up to 40 percent of the premium for a slight sliver of risk.

Ultimately, I would venture to say that most people, the overwhelming number of people, have no idea that that mortgage guarantee insurance premium embeds a large commission to their originator or their servicing entity.

You know, it sometimes is a great concern to my community or to the mortgage broker community when mortgage brokers are routinely criticized for up-selling and yield spreads and prepayment penalties and all the rest, and we agree that some of these concerns are legitimate and should be addressed.

But we forget to add on that loan officers at lenders up-sold, and loan officers at lenders got extra commissions based upon their sales practices. The wholesale community paid up on wholesale lending to correspondent lenders or lending communities rather than brokers for loans with prepayment penalties. It's not just mortgage brokers that have a problem. It was all of the community.

Of course, to include that dollar figure before application is problematic, in our view. How are we supposed to figure out how much we are going to charge the consumer if we

don't even know what the loan program is or the loan product or their credit score, what are their assets, what is the loan-to-value ratio.

To us, we are not afraid of a disclosure. We already disclose the yield spread on the HUD-1. We already disclose the yield spread on the good faith estimate. Under the proposed rule that is soon to be released, my understanding is that HUD is once again going to recharacterize yield spreads again on the new good faith estimate.

We believe that ultimately including a number, a dollar figure, in that form is duplicative only for one group and ignores the Pandora's box of indirect payments from so many different sources, from so many different areas, it is ultimately unfair to the mortgage broker community.

All we ask for is, treat us the same. Let us compete. Give us the same disclosures as everyone else, and we'll be able to compete and distribute appropriate products. Thank you.

MR. SIVAK: Okay, thanks. We are going to go with Shanna next.

MS. SMITH: Thank you. We agree with Joe in the sense that all loan originators must be included in this, but for a different reason. We find that more often than not when pricing discretion is allowed in lending, whether it's mortgage lending or auto lending, that we see -- as well as the Department of Justice consent decrees document -- that women, senior citizens, African-Americans, and Latinos end up having the products that have the highest interest rates and the loan terms that have the highest fees.

In fact, the National Fair Housing Alliance in October, November, and December of last year conducted some testing of banks where we sent in African-American, Latino, and white homebuyers. In testing, as you know, the whites are less qualified than the African-American and the Latino testers.

The testers were all middle-income folks. We weren't testing low- and moderate-income issues. We were testing middle-income access to loan products. At these banks, what we found was that either they were refusing to do business with the African-American or Latino buyers, or when they did provide loan information and loan products, the Latino and African-American homebuyers got the loan product that had the highest interest rate and fees.

Now, what we need to do is be able to compare, as Joe was saying, what happens at the brokerage level as what happens with the loan origination level. The difficulty is that whenever you allow someone, when their compensation is based on what they sell and they have

that discretion, it is inevitable that they use that discretion to the group that either they don't like or they view as most gullible or vulnerable, which often is women, senior citizens, African-Americans, and Latinos.

The issue is when you go to a bank you do think that is a trusted advisor. Sometimes people are a little leery with mortgage brokers, but they often have a better relationship with the mortgage broker because they are more accessible.

If this is your trusted advisor, you need to be able to get the information, the true information, about the cost of the loans, all the different loan products that someone is eligible for.

Our concern is if we have to have YSPs that we do have much better disclosure. I think all the things you said should be disclosed, Joe. However, from the fair lending standpoint, we find it's better if there is a fixed price on a loan product.

In the early '90s, when Justice was actually doing litigation in mortgage lending cases, they required a number of the banks to get rid of the compensation so that if you pushed a prepayment penalty, if you pushed the highest rate, you got a higher compensation as a loan originator. When those were removed, we found when we looked at the business practices that African-Americans and Latinos and women had better loan products offered to them.

The final thing with this on the rule -- what we are a little concerned about is that while you may have the disclosure, we are not sure the rule can deal with the bait and switch that happens. So you may get these disclosures, but then what happens when the person goes to closing and the documents are changed?

MR. SIVAK: Thanks, Shanna.

MS. BRAUNSTEIN: Shanna, the rule has a prohibition in there from compensation being any higher at closing than what was initially disclosed to the consumer.

MS. SMITH: But if they change the loan product, is that going to be re-reported then?

We are talking about the initial amount, but then often they may learn something else about me as I'm applying or there may be some tweak and the change, and then you get at closing this new amount that you have to pay. So I'm not quite sure how that is going to be addressed. Will they get a new loan application?

MS. BRAUNSTEIN: Part of this was to try to untie compensation to specific products -- that you are compensated for services you perform for the consumer regardless of what

product they get.

MS. SMITH: Regardless of the product?

MS. BRAUNSTEIN: Yes. The compensation is not supposed to change at closing even if the product type changed.

MR. CALHOUN: It has been our widespread experience that borrowers view mortgage brokers differently than they view lenders. It's not a perfect dichotomy, but there is a clear difference. In fact, it's encouraged by the mortgage broker industry.

I think at one of the hearings last year, information came out that the National Mortgage Brokers Association's (correct name -- National Association of Mortgage Brokers) own website identified mortgage brokers as a trusted -- as a mentor to guide you through the mortgage process.

That is how their own website described it. Mortgage broker ads regularly say, "Let us do the shopping for you and help you get through what has become a very complex market." I do think there is a different role and a different perception.

I would note that there are functional differences, too, that lie behind the RESPA rule. Certainly, many lenders who are having to buy back loans that they made today wish that they were just mortgage brokers and didn't have all those responsibilities that legally attach a distinction between the mortgage broker and mortgage lender.

Lastly, on that point, there is a level playing field. Mortgage brokers can choose to become mortgage lenders. In fact, a number of them do, and it is advertised on their website that that's an option for them.

The most important thing you can do in yield spread premiums, and I apologize for sounding a bit like a broken record, is the high yields for premiums have been most abusive in the subprime market. The best way to deal with them is through the prohibition on prepayment penalties, for this reason.

The lenders by rate sheet require prepayment penalties to get a very high yield spread premium, and that reflects the economics and function of it. If the yield spread premium is actually accruing to the benefit of the borrower through lower up-front broker fees or other up-front fees, you don't need a prepayment penalty to lock the borrower into the loan because there is not a better loan out there.

If they try to get another loan, there is not the risk that someone can immediately

come and solicit them for a lower-cost mortgage. They are getting a fairly priced mortgage. They got credit, if you will, for the yield spread premium.

However, when you add in the prepayment penalty, it changes that dramatically -- that you could have a very large overage, and there is not a rational escape for the borrower. You, in fact, reward the highest yield spread premiums.

Given the challenges, I'll talk about them just quickly, of how you capture the yield spread premium in the regulations, it's another reason why the most effective way to go at them is the role that the prepayment penalty plays.

If you don't have the prepayment penalty, market forces intervene and work as they should, and a lender is not going to pay a large yield spread premium when there is a significant risk that the borrower can be immediately solicited and qualified for a cheaper loan and the borrower is going to move away. The lender has paid the cash yield spread premium at closing and doesn't have a chance to realize it.

If the borrower got the benefit of the yield spread premium, there is not a cheaper loan out there. It's a fair bargain for the lender and one they are willing to try.

On the specific mechanics of the rule, and I think these illustrate some of the problems, the requirement of the fee disclosure, broker fee disclosure, is triggered by an application or the taking of a fee from a borrower.

In the typical subprime mortgage, that happens at closing. The typical loan application is part of the closing package in most subprime closings. A lot of it is because data is changing, the loan product is changing, et cetera, but it is very hard. I would urge you if you are going to stay with this construct, there are some alternative ways -- pulling a credit report, first substantial contact. There are other markers out there to trigger the disclosure requirement.

Second, the nature of it is hard to make it a meaningful disclosure. As it is described now, it is in dollar terms the largest possible fee. As Joe has indicated, at that point you don't even know necessarily what type of product that the borrower will end up in, and the fee may vary.

That is going to lead to people disclosing very high, the highest possible fee there could ever be to provide coverage. Then it becomes a pretty meaningless number for shopping, and it lends itself to the unscrupulous market participants to say, "This is just another federal form that we are required to disclose. Don't pay any attention. Things are going to change as we go along."

Equally, there are challenges of how you do the lender compliance. As the regs are written now, the lender complies with this provision if the total yield spread premium and the other disclosed compensation to the broker is simply less than the maximum possible fee that was set out in this early fee disclosure.

We worry that that, in fact, insulates lenders who have worked with brokers where they know by their own rate sheets that there is an extraordinarily large up-selling occurring. Again, that’s why our approach, I think, throughout these issues is the approach that to try to stop the end conduct is very difficult if you don't address the market mechanics and the market incentives.

Right now you see steering and large yield spread premiums because they are very profitable and because the structure of the market now rewards that behavior. It has no prohibitions for it. The prepayment penalties are really the hub at the center of the wheel of a lot of these end results that we are trying to address. The only effective way to address those, we believe, is by changing that dynamic that the prepayment penalty adversely plays in subprime lending.

MR. SIVAK: Okay. I've got Joe and then Alan, and then we'll move on to the next topic after Alan.

MR. FALK: Mike and I have gone round and round about these issues. I would say to you that we can get way into the weeds, you know, and into all these hypothetical realities. But at the end of the day, we believe that two competitors sitting right next to each other in a strip shopping center, they both say mortgage company, they should be disclosing the same types of information at the same time in the same way so there is a use and an ability of a consumer to shop and compare between different channels, different types of loan programs, different types of vendors.

By not disclosing certain forms of compensation, not disclosing certain cash flows by certain folks, and making direct competitors disclose those before application in some cases or whatever belies the real nature of all these different cash flows flowing back and forth between all the parties.

Our sense is, give us a chance to compete and we'll compete on it. Mike and I have gone round and round. We get criticized for what we do disclose. People that are not disclosing are not criticized, so how does that work.

Lastly, I would say that mortgage brokers provide good services and facilities, not just services. We advertise, we have storefronts, we value long customer relationships. It's more

than just a service that is being purchased in this process. It is more than that. It's good services and, in our view, facilities as well.

MR. WHITE: I think that the broker rule and the early TILA disclosure rule, which are two separate provisions in this proposal, are really trying to get at the same problem. My recommendation would be that you break those two off and do some work with HUD to really deal with the underlying problem.

There are really two problems that yield spread premiums are a symptom of. One is that there is price discrimination, that there is an ability to have discretionary prices. Given a particular consumer, the retail seller has the ability to charge them a wide variety of prices, and the consumer has no information about that.

The second, and it is very related, is the bait-and-switch problem -- that prices are not revealed at the point of shopping. Prices are revealed at closing when, obviously, it's too late to do any shopping. The price revelation problem has been well understood in the mortgage market for 10 years.

In 1998, HUD and the Federal Reserve wrote a joint report that basically outlined the solution. We haven't had the solution for political reasons, essentially. There are too many vested interests who are making too much money off of this system of bait and switch and secret pricing, and they have been able to stymie what we used to call mortgage reform. Mortgage disclosure reform is a better way to characterize it.

The solution that I think everybody agrees needs to happen is to have an early, binding, written price offer that includes fees and interest rate. Then it really doesn't matter whether the fees or the interest rate are going to a broker or to a loan originator or how that is all being parceled out.

The problem is we don't have price revelation in the mortgage market, particularly in the subprime market. We don't have it in advertising, and we certainly don't have it at the point of application.

The proposal to have early TILA disclosures for refinancing just codifies the current nonfunctioning system. Right? Because the proposal, as I understand it, is to extend the rule for purchase money loans to refinancing loans so that three days after application a consumer gets their so-called early TILA disclosure.

Well, that’s done in the market now. That’s the universal practice. It's not

required, but refinancing lenders, as far as I know, send you your RESPA estimated settlement costs and your TILA estimated loan price information three days after you apply. The problem is that the estimates are estimates, and they are a moving target and they change. Consumers complain constantly about the fact they arrive at the settlement table and see different terms in it. What could have been disclosed initially as a fixed-rate loan becomes an adjustable-rate loan, and everything else is a moving target.

Until you have a free, binding, written price offer, it seems to me that these proposals are not really going to accomplish anything. I would really urge the Board to take some leadership in working with HUD.

I know HUD is about to come about with another version of their proposal for a binding, written price offer for mortgages. People have been working on this for a long time. There should be a way to arrive at a solution.

It strikes me that it would be perhaps easier for the Fed, which is somewhat of a less political body than HUD certainly, to be able to get to that solution. That is the solution that we need.

I know there are all kinds of problems and things change -- information changes between the time a consumer applies and the time their loan closes. But the consumer needs to have binding price information at a point when they still can do something about it.

So if things change, they need to get a new set of disclosures, seven days or 10 days before closing -- at some point before they are emotionally and economically committed to the transaction, or you're not going to be able to have price shopping.

MR. SIVAK: Okay. I think that is going to wrap up our discussion on yield spreads, but it provides a great transition to one of the other important topics on the timing of disclosures.

MS. RENTSCHLER: I think Alan gave me a great segue into my comments with regard to the disclosures and the timing. As the Fed is working on these issues at the present time, revamping and taking a look at Reg Z, I think it's important to look at the timing of disclosures.

In the community bank environment of which I am a part, I've had several thousands of people come in and apply for loans. Well, there become several different issues that come about.

They will come in, and the trigger is that if they come in with a real estate address -- 123 Main Street -- that triggers the three day. They are going to go out and buy that. They want to pay $100,000, for an easy number, so you start to give the disclosures. A week later, when they finally get off work again the next Saturday, they bring in the contract, and the contract is totally different than what the disclosures that you have given them previously are.

They include the termite, the survey, a lot of different -- maybe the sales price is obviously totally different in a contract most of the time. So then you give them those disclosures, so they've got two. Then the termite inspection has failed, and then they agree to split part of it. The sales price could change.

The amount that the borrower has to pay as part of the closing costs -- that changes as well. A third set, and this goes on. At what point do we need to say, hey, four or five different disclosures -- confusion reigns in that borrower and they come back in and say, "Anna, I don't understand. I've seen this so many times. What is my final cost going to be?"

Also, what that brings to mind is often times they will come in, the borrower will come in and talk to you and say, "Do you want to lock this rate?" Then you've got your basis that you are determining the rate. "You know, I think the rates might go down so I am going to wait." So you have given them the disclosures based on what you assume the rate would be at that time.

However, they have chosen on their rate lock, or not lock, sheet to say, "I want to wait." At what point do we get locked into that? They finally call in three days prior to closing and say, "Okay, I'm ready to lock. I think it's good or it's moving. I want to lock now." So then we re-disclose again. Again, five or six different things can come into play there.

I think it's really important, and I'm going to give you a little bit of anecdotal evidence on that. One of the people that now works for me at our Bancompany is a college graduate. She has been in the banking business for quite some time. However, she wasn't in the mortgage area.

She and her husband got into a little bit of financial difficulties, and when they went to buy their home they got disclosures. I have them here with me. It was a fixed-rate, 30-year mortgage. I think it was way too expensive, but then again she wasn't working for me at the time so I couldn't guide her there. She went through all the disclosures. Everything is here.

Then she went to the closing table, she and her husband, and sat down and it was an adjustable-rate mortgage. She did not know what to do, and so she signed the papers. She's

scared, and she doesn't know she can back out at this point. She just is totally rattled by the situation so she signs them.

Because it's a subprime mortgage and because they have had financial difficulties, and she is the first one that would tell you that, she does have to make the payments on time. How they worked it is this lender says, "You have to use our electronic payment channels or we will start foreclosure the next day." They are kind of giving her a little scare.

I said, "No, they can't quite do that. They would have to publish, etc., in the foreclosure environment." However, she says, "Okay, I'll make my payments through your channels." Then she said, "Anna, they charge me $20 every time I do that." In addition to subprime, subprime, subprime, they are taking $20 when she makes her payment on time.

That is when the hair on the back of my neck stood up. Besides the bait and switch, she is also getting tagged every time that she has to use them and she can't use any other things. We're a bank and it isn't our mortgage, so she could use other means so I think it's really important.

With regard to some of the issues we've talked about today and in the disclosures as they now sit, there is a box that we indicate there is a prepayment penalty. If you pay off your loan early, you will or will not have to make a prepayment penalty.

I think that maybe this needs to be bolder, maybe red flashing lights. I don't know what it is, but I think they are signing on that and they don't know if prepayment penalties in effect are required.

Variable rate -- I think on the disclosures this, too, ought to be very clear. Especially when you are determining the APR, it's really hard to come up with the thought process when you are not used to how we come up with the APR, especially on an adjustable-type basis.

As an aside, having closed many, many loans and since you are looking at the Reg Z proposal, if you pay off your loan early, you may or may not be entitled to a refund of part of the finance charge.

I think just about in every closing they say, "You mean I'm not going to get my finance charge back?" which is in the big highlighted box at the top. That is the total finance charge, so that needs to be clarified as well.

I think it is really important that the re-analysis, the timing of the disclosures, how it affects the bank or the broker, whomever it may be, with regard to lock, not lock. Some decisions

are made and not known.

I think it's important to realize they need to be standardized disclosures. However, additional pages, additional words and length does not necessarily make it a clear situation for the borrower.

MR. SIVAK: Kevin is going to have the last word on disclosures.

MR. RHEIN: I just wanted to mention, the way the regulations are drafted is unless you get a very specific disclosure, the only fee you can collect is a credit processing fee, essentially.

That can create some significant issues on the hedging side. So for those individuals that want to lock in a rate, unless we are able to charge, for example, an application fee that would offset some of the cost of the hedge, I would just be a little bit careful around the definition of what fees can be collected in lieu of the complete disclosure.

I think the absence of being able to offset some of that is going to force many borrowers not to be able to lock in, could cause rates to change, and I think there could be increased cost of credit as a result of that. I would just look at that definition a little more closely.

MR. SIVAK: Okay. Our next topic is going to be on servicing practices. The proposed rule is specifically looking at when payments will be credited, how late fees are put in there, failing to provide payoff statements on time or in a timely manner. I'm going to ask Terry to go ahead and kick us off there.

MR. THEOLOGIDES: This is a little less controversial than prepayment penalties and YSPs, I think.

A few thoughts on servicing. By and large the proposals, I think, make sense, conform to some of the industry best practices. There are a few technical details that I think merit some further thought, particularly on the requirement for the schedule of fees.

While many fees that are controlled exclusively by a servicer are fairly straightforward about disclosing, third-party fees can change -- some of them like hourly rates of foreclosure counselors or other things.

It may be worth considering bifurcating the disclosure between the servicer fees that the servicer retains as opposed to third-party fees that the servicer is passing through that may change from time to time.

There are a subset of third-party fees that are also very difficult to know in

advance -- fees to repair property damage, correct code violations, fees of that nature. Again, I think in principle it's the right idea. I think it is difficult to really say that with great certainty all fees are knowable in advance.

I think the other thing, and I'm wearing my compliance hat because I'll have to implement this in my organization, is also recognizing that from time to time fees do change. From time to time, different states have different requirements of fees and making it clear that -- I guess making it not impractical about how we disclose whether a fee every year -- you may change a particular fee. It may go up, it may go down. But making it clear that the fact that you posted that or distributed it to a customer two years prior upon a request doesn't mean that you have to necessarily re-disclose every time you tweak a fee or there is an additional service, an additional technology that has a cost associated with it and that you provide for a fee.

The other thing I think, again, the pyramiding of late fees makes sense, and I think is consistent with every servicer I've heard of. I think crediting payments as of the date of receipt and recognizing that there may be times when logistically you actually post the payment, but as long as you credit it as of the date it was received struck me as, again, sensible and consistent with best practice.

MR. SIVAK: Any other comments on servicing?

MR. RHEIN: A couple of real quick ones.

MR. SIVAK: Sure. Go ahead, Kevin.

MR. RHEIN: The penalty structure as it's written -- our take is it seems incredibly harsh when you start to talk about, if you have a minor error that could lead to a huge liability. You've got down the penalties for violation would include not only attorneys fees, statutory damages, but also all finance charges and fees paid on the loan. In terms of what the violations would be and what the remedies might be, I think that is something that ought to be taken into consideration.

The other thing is how to handle partial payments. I think sometimes that's where there can be a question as to whether the servicer applies it or they hold it waiting for a full payment. I think the regulation might want to specifically address any expectations around partial payments.

MR. SIVAK: Okay. We've got two more topics and we've got five minutes. Let's go ahead. The last two involve marketing practices and coercion of appraisers.

I think, on the prohibited practices that have been proposed for closed-end

mortgage advertisements, one comment that I would like to make on that is there is some proposed language around how you advertise, how you use the word “fixed.” We talk a lot about bright lines in here and being very clear.

I think that if you're going to advertise with the word “fixed,” it should be fixed. The payment should be fixed for the entire length of the loan. If it's going to change at any time during the loan, then that word “fixed” should just simply not be allowed to be used in the advertisement.

With that, I'll open it up for additional comments about the rules that have been proposed for advertising on closed-end mortgages.

MR. WHITE: The one comment I would make about advertising for mortgage credit is in the world of risk-based pricing, determining a price for an individual borrower through advertising is a very difficult thing to do, right? In point of fact, any given consumer, even if you know their loan-to-value ratio and their FICO score and a couple of other variables, there are still going to be dozens of products with different price points.

I think, on the other hand, in the world of the Internet and modern technology, there are ways of providing cheap information for shopping purposes to consumers that could be either mandated or at least highly encouraged through this kind of regulation. I think what some of us would like to see, ideally, is that a consumer can sit on a website and put in the variables, the independent variables, and produce a rate and points and then maybe some combinations of rates and points.

Every lender should basically make their rate matrix electronically available to every consumer. How you get to that ideal, I think, poses a lot of practical difficulties. Right now rate matrices are secret. They are not available to retail customers. Brokers can get them.

If you're a very diligent consumer, you might figure out how to find out what the wholesale cost of your loan is and then maybe that would give you some leverage the way people do that with automobiles now. But it is a very difficult thing to do.

I would really encourage some further thought about how risk-based pricing can be disclosed through advertising and required to be disclosed. Certainly, to the extent a lender has calculators on their website, they should make available the capacity for consumers to put in the variables that determine the price and get a price that really will be the price.

Otherwise, it's inherently misleading. Subprime lenders are going to advertise the

minimum rate or a range of rates, and a consumer really is not getting useful price information through advertising.

MR. SIVAK: Okay, Sarah.

MS. LUDWIG: Just very quickly on the subject of fixed and the way that it gets reported and marketed. Our legal services partners in Brooklyn have been seeing a spate of mortgages that are marketed to people, particularly seniors, who have ended up with these mortgages in just the last few months that were fixed for two days. Two days.

MR. SIVAK: All right. With that we are going to move on to the final topic on coercion of appraisers. This is specifically about basically prohibiting the creditor from coercing an appraiser, specifically in the interest of driving up a value on the home or misrepresenting a value and prohibiting the retention based on the value or failing to compensate based on value.

One question that I would be curious to get some feedback from the folks on is, would it be appropriate to apply this rule to creditors paying this to their employees? I think, from my own perspective, the appraisal process is one that needs to be -- sanctimonious is probably the wrong word, but it basically needs to be like a judge, basically.

Hopefully when you go before a judge, you know you are getting an independent judgment that is being made. I think when a consumer is going through the process of the appraisal, that process needs to have that same level of credibility.

I think the rules are good in terms of preventing coercion. I actually believe that it should be then also extended out to creditors' payments to their employees as well, in the vein of Joe, to cover everyone.

Any other comments on that? Yes, Edna.

MS. SAWADY: I'm taking the risk of being accused of nitpicking, but when I see a rule that prohibits coercion, I ask myself -- we all know it's illegal. Nobody will admit to coercing anybody. I am all for it, but I would just ask the Board to consider taking the word "coercion" out so that it really could put the focus more on the more subtle ways of influencing, which are the problem.

Coercion -- I don't think anybody would admit to coercing anybody, but they could be cajoling, could be influencing. There could be many other more subtle ways that we don't want buried in the context but more highlighted. Negotiating. That's another one. Schmoozing.

MR. SIVAK: Shanna. Shanna gets the last word.

MS. SMITH: I just have a question. When an appraiser is influenced or cajoled, there should be a process for them to be able to report that. Here we are protecting -- we are telling the creditor not to do it, but if you're the victim of it, we should figure out a way to report that.

I guess I just want to bring up -- it's sort of like when you are completing your mortgage loan application. If you are the borrower, it says, "If you provide any false information, it could be a felony." But it doesn't say if the loan originator puts false information on there or you are looking at that application and you sign it, that you're in trouble.

But if that loan originator did something, we're talking about disclosure, shouldn't it be there where the borrower would be advised, "If they falsified information, here is the number to the U.S. Department of Justice," to file a complaint. I just wonder how we are going to protect the people who actually do get coerced.

CHAIRMAN BROWN: I don't know where I fall on this issue because as a developer you obviously want your properties to appraise high. As a homebuyer, you also want to see that there's value. The issue of critiquing the appraisal, I mean, I've been on both sides of this issue.

Because we are developing in less desirable neighborhoods, taking the factors that don't necessarily weigh in on the value of that development, then you find often times that you are negotiating with the bank because their reliance on the appraisal is taking in the factors of elements that, of course, there haven't been any home sales because no one has invested in the area.

The issue of cost and the market price is one you can't determine when you are pioneering into that investment. This rule sort of addresses from the standpoint of when the appraisal is being raised, or the question of the appraisal is done in such a way to help the buyer get into a home that may not appraise, so I think it's a slippery slope.

I think there could be unintended consequences that will reverberate, and I just don't know where -- I don't have any guidance to give other than to say this is not science and that the issue of coercion really is one of negotiation and it is a difficult issue to try to regulate.

MR. SIVAK: I think we are ready to move on to foreclosures at 11:30. Is that right?

CHAIRMAN BROWN: Let's see. I was on my soapbox and I forgot I was supposed to chair.

MR. SIVAK: I punted back to you to keep it moving.

CHAIRMAN BROWN: Thank you, Ed. I didn't get it, man. I'm sorry. You have to wink at me next time or something. Give me a thumbs-up.

We will continue our meeting by discussing issues related to home foreclosures, such as loss-mitigation strategies and counseling initiatives. About 1.5 million adjustable-rate subprime mortgages are scheduled to have their interest rates reset this year. That is significantly more than in 2007, and another one-half million are expected to adjust in 2009. Many borrowers will find it challenging to make the higher payment.

Yesterday members of the Community Affairs and Housing and the Compliance and Community Reinvestment committees discussed various efforts to protect homeowners and communities from the adverse consequences of defaults and foreclosures.

To lead a discussion on what is happening in the various markets, Dorothy Bridges, chair of the Compliance and Community Reinvestment Committee, will kick off and lead the discussion.

Dorothy.

MS. BRIDGES: Thank you, Tony. It goes without saying, and I think every committee of the Council, or subcommittee of the Council, has this as top of mind. We’ve heard story after story. We've read news reports after news reports of the fallout from subprime lending. What probably started as a noble cause ended up pretty bad for communities.

There are a number of initiatives around the country that various different Council members talked about to help with the foreclosure crisis, even in my own back yard. We heard from an individual, Chris Warren, who is chief of Regional Development in the city of Cleveland, about the vastly negative impact on his community and some efforts that are being done to help turn the situation around.

In my own back yard, we have experienced foreclosure rates increasing from 5,000 in the state of Minnesota in 2005 to 20,000 in 2007. Predominately in the urban core of the city of Minneapolis, North Minneapolis particularly, you can drive down the street and just about every block you have at least two homes that are foreclosed. Not only are those homes themselves impacted, but the other homes where there are legitimate homeowners in these low- and moderate-income communities are impacted.

Several initiatives have been going on in different parts of the country, and I will invite my colleagues on the committee, the Compliance and Community Reinvestment Committee,

to discuss some of the things that are going on. But before that, let me tell you a little bit about what is happening in our city of Minneapolis.

We have a number of organizations that are partnering with financial institutions to provide capital back into the communities to help provide counseling and education to a number of these homeowners who are faced with losing their homes or who are delinquent in their loans at least.

We are also looking at opportunities, where individuals who have lost their homes and have moved out of the community, for organizations such as not-for-profit community development corporations to gain site controls of these homes, rehab them, and resell them to first-time homebuyers to restock, if you will, our communities.

The coordinated plan that was developed by Family Housing Funding and a number of different organizations in our community are looking at various different ways to address these foreclosures, not only in the Twin Cities but in the entire state of Minnesota.

What I would like now to do is ask some of my colleagues to talk about efforts against the backdrop of CRA and its 30th anniversary, some of these things that financial institutions can do and gain credit under the CRA rules for a lot of these activities and these initiatives. I'll call on Louise.

MS. GISSENDANER: Thank you. First of all, I'm out of the Cleveland market, and I would just like to kind of preface some of my remarks with some of the devastation that we are experiencing there before going into possibly looking at ways or solutions.

This might be helpful because actually Chris coined it as consider the wreckage in Cleveland because that is pretty much the issue here. We have well over -- well, actually over 17,000 foreclosures since 2002, with 80 percent of those actually being linked to the high-cost subprime mortgages. This is pretty significant because it has impacted the city in a number of ways.

Right now we have over 9,500 vacant residential structures. I'm just talking about the city. I'm not talking about the state. It has significantly impacted us. Actually, the city spent over $12.5 million just to demolish boarded-up properties because of safety issues. They spent an additional $2 million just last year to do cutting and clearing of these vacant lots. This, again, is expected to even be more, larger in terms of budget in 2008.

The other real issue besides crime and other things that has occurred because of these vacant and abandoned properties is the fact that we actually had the Cleveland Fire

Department respond to more than 600 fires at these vacant properties. This is a 250 percent increase over 2006. The budget came in well over 30 percent.

With that being said, we are in a crisis mode, so we have tried to figure out ways in which we could manage this. How do we get our arms around this issue here. Some of the things that we've looked at is talking about imposing a one-year moratorium on foreclosures of owner-occupied properties -- not investor properties but at least owner-occupied properties because we feel like we need to leave people in these houses. We just can't take any more vacant properties.

How that's going to work out is still being discussed through the city because they have actually formed a pretty significant committee to try to really evaluate some of these things -- again to really look at getting some additional assistance through looking at the property and really seeing how the state and others could continue to assist us.

Overall, the real big issue is to really look at maybe an emergency relief, foreclosure relief kind of program that might be helpful to those cities that are experiencing that kind of a problem in terms of abandonment of housing.

Actually, because of that, the mayor filed a lawsuit really with looking at the 21 lenders in the city and trying to find a way to really hold them responsible for this issue.

This is kind of a way of just really putting focus on the devastation that these lenders have created -- who are not lenders who are really local lenders but from all over other places because the city was actually targeted. Again, it's not just Cleveland. Cuyahoga County in general, where Cleveland is located, actually is also experiencing some major difficulties.

The other thing is there is a program that is being put in place called Reclaiming Foreclosed Properties and working with, again, foundations, local banks in the state of Ohio to create a foreclosure properties initiative.

This initiative is actually looking at targeting six of the neighborhoods in Cleveland and trying to really just work specifically in those neighborhoods just to get them firm.

In that we are also looking at lenders donating some of their REO properties, and that can go back to nonprofits that can actually rehab these properties and get them back on track. And to also look at possibly banks paying for demolition of those properties where there is no way that those can come back online.

One other initiative is the countywide property bank where properties are being donated to the city and them trying to again take those on. The difficulty, as you have already heard

-- they can only take on so many because it still costs the city to hold those properties.

This is just a few of the efforts that have started in the city of Cleveland. Just to sum it up, basically the city is feeling like this is so overwhelming that they might recover in five to 10 years, but really, without help, it could take a century to make this city come back to the way that it was.

MS. BRIDGES: Greta.

MS. HARRIS: Thanks. I work for a community development organization that has a footprint nationally. I have had the pleasure of working in the field for the last 20 years along with many colleagues sitting around the table.

I think the situation that we find ourselves in now, that we are seeing in places like Detroit and Miami and Philadelphia and parts of California as well as other communities, is that two to three decades of very positive community investment and growth and progress is really at risk of being lost because of this mortgage crisis that we find ourselves in today.

It was a very robust dialogue that we had in the committee discussion yesterday. One of the ideas that started to bubble up was the idea of potentially profiling targeted neighborhoods that have a very high or disproportionately high concentration of foreclosures so that they may be qualified almost as a natural disaster status -- but it's a manmade disaster status -- that would encourage, in particular, financial institutions through CRA to provide creative lending or capital access to those targeted neighborhoods.

In some ways, it is almost like where we were 15 or 20 years ago in some neighborhoods where it didn't make economic sense to go into these communities because they were upside down, the values were going down or had been stagnant for a long period of time.

From a safety and soundness perspective on the bank, it would make the hair on the back of your neck sort of stand up to put capital into those communities.

However, if it was done in a thoughtful way in partnership with nonprofits that are community-based that will be working in partnership with local governments to start the public/private blending of financing to rebuild and really be a catalyst for rebuilding the markets in these communities. Linked to the conversation that we had about the proposed changes with Reg Z, it's all related and I am so impressed with my colleagues sitting around the table.

That is not my game right now, but I would just encourage the Board to think about the balance as you are looking at these proposed changes between certainly supporting free-

market activities and balancing those with equitable access to capital, especially in low-wealth communities and communities of color that have had a disproportionate amount of adverse effect by just letting the free markets go on their own.

Whatever this new generation, next generation of mortgage practices will be, I would encourage the Board again not to just encourage people or practices that say, we are providing the access to capital to these underserved markets, but to provide access to capital to these markets such that people can realize the full benefit of homeownership or growing a business in a way that is equitable and fair.

MR. NARAIN: Let me preface my remarks by saying National Community Investment Fund invests in CDFIs and minority banks around the country.

As the subprime crisis unfolded itself, you are doing a stress testing of the portfolios of these institutions, and it's fascinating to find that most of these institutions did not actually originate or hold on the books any subprime loans, whether it's large, small, or even commercial real estate related.

This is not to say that the portfolios will not get affected through an indirect impact. But it is in that context that I want to make three remarks.

One is CRA credit. We saw in the context of Katrina that the regulators came out with a specific statement saying it is a natural disaster and, therefore, institutions assisting in the resolution of these natural disasters should get favorable CRA credit even if the institution investing was found, that the investee institution was outside the assessment area.

In a certain sense, if we want to promote the national institutions to actually go out and support forclosure subprime resolution efforts, then it is something that the Board could consider and the regulators could consider.

On the same vein, under FIRREA 308, minority banks have a similar benefit for large investors coming in and investing in smaller CDFI banks even if the CDFI banks are not in the assessment area. I would urge the Board and the regulators to think about the fact that CDFIs by certification are focused on helping low-income communities and have proven to be so in the context of the subprime crisis.

The third point that I raised yesterday as well in our committee deliberations was a potential land mine here. As we encourage banks to go and do restructuring and refinancing and changing the terms of the loans, we should be cautious of the fact that the safety and soundness folks

don't come back tomorrow and say, "Your portfolio section is tainted now."

This could be particularly problematic for the smaller banks who, if they sort of step up and take on larger loan portfolios which are sort of restructured, they could have a problem on their balance sheets. Again, I would urge we sort of think about this.

MS. BRIDGES: Thanks.

GOVERNOR MISHKIN: Can I ask for clarification? I just want to understand exactly what problem would occur so I understand this. If you have a loan that is already in trouble and you are doing a modification, it doesn't make sense to do the modification unless it actually would put you in a better situation.

Clearly, there are issues whatever you do. I'm trying to understand how you feel that this might actually lead to a safety and soundness problem.

MR. NARAIN: The supervisors could come in and say, "Your portfolio has got a substantial portion of loans which are in the restructured category and therefore there will be heightened sense of scrutiny."

GOVERNOR MISHKIN: Even though they have had a problem before, you think they would only come under more scrutiny if they are restructured? The loan is already effectively a bad loan, and now you are restructuring it to hopefully get more value for the institution and also to benefit the household that is in trouble as well.

MR. NARAIN: Actually, the problem becomes bigger if they actually take on loans which are originated and held by somebody else.

GOVERNOR MISHKIN: Okay. So that's what you're worried about. Okay. Fine.

MS. BRIDGES: Alan and then Cooke.

MR. WHITE: I want to talk a little bit about the need for information about the foreclosure crisis and the efforts to try to mitigate the problem.

I hear from a lot of advocates and housing counselors about their frustration that there are a lot of loans in foreclosure or approaching foreclosure that they think could be successfully resolved and they are not able to do that just because of the capacity issues with servicers.

You hear from the mortgage bankers that really a lot of the problem is there are homeowners who either make no contact at all with their servicers or who have repayment plans and

broke them.

The information that's available about mortgage delinquencies and mortgage servicing -- none of it is really coming from objective sources, with all due respect to Faith. I think there is a really important role for the Fed here. The Fed releases all these monthly, weekly, daily statistical releases.

Right now, I think what not only policymakers who are trying to tackle this huge human problem are interested in, but also what the international financial markets are interested in, is knowing just exactly how far this problem extends, how much what we're doing in loss mitigation is helping or hurting the problem, what are the losses and when are they going to get realized.

That information is incredibly difficult to extract in the current information marketplace. We have the Mortgage Bankers Association that gives us the National Delinquency Survey, which has about a 90-day time lag and is only issued quarterly. It's not free. You have to pay money to get the actual data. Otherwise, you get the press release which, I'm afraid to say, spins the information considerably.

We have now -- thanks to HOPE NOW, and I want to tip my hat to the effort to gather information because that is really valuable -- there is now some information about how many foreclosures there have been.

For example, we now know from HOPE NOW that there are probably a million and a half foreclosures started in calendar 2007, but only 500,000 of those resulted in actual foreclosure sales. So that is kind of good news, although there is an ambiguous outcome for some other group of people who maybe had pressured sales or distress sales or deeds in lieu, which we don't really know.

We do know that in terms of loan modifications, that activity improved considerably. There were 237,000 of those for the calendar year compared to half a million foreclosure sales. That could be better.

Now we know from the January report that they are running 60,000 a month, so that's an annual rate of three-quarters of a million. So that starts to approach a number where you have as many loan mods as you have foreclosure sales, which is better.

But we are still lacking a lot of information. We don't know on these loan modifications how much are they being modified. Is principal being impaired? Is interest being impaired or are we just postponing payments until a later date? How successful are the

modifications? How many re-defaults are we seeing?

There is a certain discrete number of data points that we could collect and report that would enable a lot of things. It would enable, first of all, investors around the world to have a little more sense of comfort as to how far the damage is going to spread and what the ultimate losses are going to be.

I think to me, more importantly, it would enable policymakers to think about some of the options that are being considered now and talked about, like the homeowner loan corporation kind of model of coming in and purchasing at a discount a lot of mortgages. That would make sense under certain scenarios, and other scenarios that maybe there aren't that many mortgages that are really well suited for that approach.

I think just taking the reporting that is being encouraged now by the regulators but being done essentially on a voluntary basis and turning that into a survey that is done by the Fed and that is reported publicly would be a tremendously valuable thing to do to enable us to figure out what is the maximum that can be done to mitigate this problem.

MS. BRIDGES: Cooke.

MR. SUNOO: Saurabh, I think Greta also mentioned the idea of using, encouraging banks to participate actively in getting us out of this mess and perhaps using the mechanism of the CRA regulations in applying the grading under CRA. Then the idea that perhaps we could look at these areas and designate new impact areas.

I think actually a lot of the areas that are impacted are those areas that are already those low-mod income areas. Interestingly in California, in Southern California particularly, there are a couple of subdivisions that would not qualify because these are first-time homebuyers that simply just over-leveraged themselves and are in a very bad position today.

Going to designation of new areas to me implies kind of years of getting around the different tables to straighten that out and seeing how that gets done. I think one thing that we could do -- and since there is some overlap, I would imagine, with the existing low-mod income areas -- what we might do is consider, in CRA examinations that are ongoing, simply to preamble that the banks in looking at their CRA requirements also address the mortgage debacle that we're in.

If we get designations down the line, that's fine, but I think in the immediacy putting that type of a preamble on would then encourage our local banks to not just do business as usual in their community development work in the low-mod neighborhoods but say, "Ah, ha. I can

get extra credit for taking on a new initiative to deal with this debacle that is in our neighborhoods."

MS. SCHWARTZ: I would just like to thank Alan for the compliment about HOPE NOW, but the integrity of data, I'm not sure. I would just share that HOPE NOW was created to pull the industry together to have a comprehensive response to the issues in the market.

Yes, it's voluntary, but once people join HOPE NOW -- there are 27 servicers, over 90 percent of the subprime market and a vast majority of the prime market who are participating -- there are a set of principles that they do agree to, and one is reporting their data and sharing it.

We only will share in an aggregate form both at the state level and the national level to understand what is going on. It took two months for several lenders to get together to figure out what is a modification versus a repayment plan and to share exact foreclosure data and foreclosure starts.

It is extrapolated, and it isn't perfect. But we're covering the market in an effort to be transparent and in an attempt to get at the problem, work with investors, housing counselors, and servicers. It's really quite extraordinary and unprecedented where we are marching down the same path.

It's not perfect. I understand the critics and the issues around it, but without it you would see less of a mission of getting this done in a coordinated way, in a more unified way. We have made great strides. It might be a little thing, but to have an 800 number for every housing counselor who couldn't get through to their servicer and they have a warm body, someone who needs help and it's escalated. Again, not perfect.

Hand-offs are extraordinarily going better than they have ever gone before, and 27 servicers now have access to portals, are investing in technology for communication with counselors, are reaching borrowers that weren't reached before.

It's not perfect, but it's an attempt to slow and avoid the foreclosures and look at every other alternative that the servicers can do on behalf of investors. It is a complicated issue, but people are at the table, and I think that is the most important component.

MS. LUDWIG: We spend a lot of time in our organization out in neighborhoods working with homeowners in distress. There has been pretty much every single night of last week and every single weekend for the last six months and every single weekend, Saturdays and Sundays, for the next six months for our schedule to get word out to people in foreclosure who are struggling

with their mortgages, to help them understand what their options are, to make sure that they avert some of the abusive solicitations we've seen from these really sleazy foreclosure rescue outfits that are out there and proliferated and are unashamed, notoriously advertising right across from courthouses. Storefront signs everywhere, "In foreclosure. Call us. We pay cash," et cetera.

We also spend a lot of time in our organization helping people understand their rights and understand some of the patterns and issues that are out there. I want to share with people a map we made and say a couple of things about it.

We are always making maps to explain to people in a really quick, graphic sense what's happening in New York City neighborhoods. I'll pass this around, maybe the black-and-white version, since I happened to have it in my bag, but I'll share the color one later.

This is a map of New York City, and we have cities within cities in New York. These boroughs, Queens and Brooklyn, have populations above 2 million. Right? What is it? Brooklyn would be the fifth-largest city unto itself? Fourth? I don't know. Certainly the best.

While we are ranking things, there are some really unfortunate rankings that we do not boast, but we see on this map. I think you can even see this from far away. Each red dot on this map represents lis pendens or a foreclosure action filing in court over a six-month period.

The number of lis pendens filed or foreclosure actions filed in New York City in the last two years has doubled. If we already thought we were in a crisis in 2005, the baseline year that I'm using, what we see on this map is a few things. We see absolutely unsubtle concentrations of the foreclosures by neighborhood.

When you get this map passed around, you will see there are diagonal lines across communities that represent neighborhoods that are more than half black or Latino. Queens is one of the most diverse counties in the whole country with an incredible array of immigrants as well.

One in every three New Yorkers -- actually a little more than one in every three New Yorkers -- is foreign-born, so we have some very interesting demographics. We also have a lot of segregation in our city, so you see this.

We keep hearing about these sort of pockets of foreclosure and thinking about these parts of the country that are most affected by the foreclosure crisis. People say almost interchangeably low- and moderate-income neighborhoods.

I want to point out that these neighborhoods in Southeast Queens that are predominately African-American around JFK airport -- for those of you who don't know New York

City as well, that’s this triangle over here -- are neighborhoods that are largely middle- and upper-income.

The Federal Reserve Bank of New York recently put out some data on credit scores and showed that these are neighborhoods where actually the credit scores are relatively high. So we really have to ask ourselves what’s going on.

We have been asked a lot -- I'll pass it this way. It will come around. As we have been thinking about these issues and working really hard to come up with coordinated citywide and statewide responses and really trying to unify a lot of efforts, a lot of elected officials and community groups have said, "What do you think about a moratorium?"

A year ago, we were a little bit ambivalent. We said, "Why would you do a moratorium on foreclosures unless there was something at the end of the moratorium for people?" If it's a six-month moratorium, at the end of six months there has to be some redress or resolution. Otherwise, you are just delaying the inevitable, and a moratorium is a big deal. So we need to figure out that it makes sense and there is something workable for people.

But we are at a moment where there are so many excellent ideas and efforts being melded and that are about to crystallize that we now think that a moratorium makes a lot of sense.

I'll just give you one example. As we encourage people in these community workshops and in public spheres and around the country to contact their servicers and to modify their loans and pursue that, putting aside all the problems that we always hear about of people getting through to their servicer and having continuity of service and getting workable solutions, there is one thing that a lot of people don't know.

We just did this Know Your Rights pamphlet for people dealing with mortgage servicers and loan modifications. A lot of people don't realize that while they are talking to their servicer to modify the loan that their foreclosure proceeding is continuing on a separate track. You could have people who we are encouraging to try to work something out, and meanwhile the foreclosure proceeding is not stayed.

They could end up losing their home because one arm of the servicer is acting in one way but not communicating with the side that is working out a modification so the person can stay in their home. And hopefully, under the best-case scenario, it is a modification that makes the mortgage sustainable.

We are starting to think that a moratorium makes sense. It’s important to freeze

the frame as so many efforts around the country are starting to really come together to make sure that we can through all sorts of creative and some more mundane means help people retain their homes.

CHAIRMAN BROWN: I just wanted to follow up on something that Cooke said that sort of caught my attention and I was curious. Maybe before I get to a point that he made in support of it, sort of a question.

My understanding now, I guess, is that most large banks are originating a mortgage and if they underwrite to an investor's guidelines, those mortgages are sold. The question then becomes, if that mortgage goes bad, in my experience that asset is no longer owned by that local financial institution.

As a community development corporation, when I am trying to redevelop a neighborhood and I see that the mortgage was originated by the local bank and I inquire with my local bank contact, I often times find that bank has been sold somewhere in California and all of a sudden I'm in cyberspace.

Cooke raised a point, and I guess if there is a recommendation to the Fed that there could perhaps be some type of interagency approach to CRA, the question is, is there some repository that you can look at loans that are foreclosed to understand, is there a concentration of foreclosed loans that have an adverse effect to a neighborhood?

From that, as you do your CRA exam, can you then assess whether or not the local bank, the local market is engaged in some effort to stabilize that neighborhood by working with their community development partner to ensure that those properties that have been foreclosed are put back into production so that the neighborhood gets stabilized?

It's sort of what I took from and maybe embellished a little bit upon Cooke's comment. What I'm finding in the local community is that there is no one watching the big ball of foreclosures and the impact those foreclosures are having in low-income neighborhoods.

I'm wondering through the CRA regulatory process if there could be some broader approach to addressing if there is a significant pattern in a particular census tract, largely in urban areas that it’s having an adverse impact.

MR. SUNOO: Can I respond to that just a little bit and say that what you say may be entirely correct. Maybe my point wasn't so clear, and that is that I'm not looking to find out who is responsible so much as looking for cures.

The big banks that are dealing in the city can provide cures to a problem without

having to be fingered for being guilty of creating that problem. I see them as two separate things that both need to be done.

CHAIRMAN BROWN: I think I understood the point. On one hand, if I'm a big bank, I'm going to get credit for the origination under the CRA. If I sold that loan and that loan goes bad, that's not my problem. How do I get that big bank back engaged?

MR. SUNOO: What I'm saying is that the problem exists there. Whether that big bank is the originator or the servicer or uninvolved directly with that loan, they should still be able to and they should still be encouraged to help those communities out of the foreclosure debacle that these communities are currently in, regardless if the big bank caused it or not. That is where I'm going with that.

There are plenty of ideas that are being floated in the communities in terms of just simply increasing counseling or creating other fresh mortgage funds that some of our nonprofits are doing today. There are other ways of getting out of it that are not -- there is not a direct nexus to cause.

MS. HASSON: When Stella (Adams) left at the end of last year, her parting words to me were, "Patty, I'm counting on you to speak for the consumer and for the counselors." Anyone who knows Stella, you don't ever want to let her down. With that in mind, I hope you will take a few minutes here and indulge me because I received an e-mail that a counselor received, and I think it's important that you hear this.

"You have given me hope and to my family when things seemed hopeless. It has been a horrific year for us but through it all I continued praying and keep pushing forward.

“You truly have been an angel we have been looking for, someone to simply listen to us and earnestly take the time to review our case with all the unfair particulars associated with it. If nothing else comes of this, we still thank you for taking this further than anyone has attempted in the last eight months."

Eight months, folks. I have had a few sleepless nights, as I'm sure a few people here, worrying, "How am I going to add counselors? Where am I going to put them?" But I can't even imagine eight months losing sleep over whether or not I'm going to be in my home.

I think it's important that some of the practices that we have seen, and Faith has talked about some of the progress that has been made, that not all servicers are there yet. When I talk now, I don't want it to be this is all servicers.

There are different practices and, again, this is the experience of my agency. But I think I do speak for a lot of small agencies throughout the country who may not be a part of HOPE NOW, who may have two or three counselors or, like us, 21 counselors.

In the past, counselors could get something done. They could have a one-on-one with the loss-mit area, talk about the budget, and get it done. That’s starting to go a little bit by the wayside. As they are inundated, they are saying, "Have the individual go to the website, fill out the forms, and then we'll talk to them."

Another thing that we're seeing is that the foreclosure area is not working with the workout department. I think Sarah touched on that, the foreclosures going forward.

Yet, a third and very important point is that our clients that come in to us state that they send the package in and they are being told it's 45 to 90 days before you’ll hear an answer. So they are back in to us now for counseling and trying to push it through from our angle.

While things have improved and we have direct lines now with a lot of servicers and we can get through, they are talking to somebody on the front end, and now we've got to push it through on another end. It seems to me wasted resources.

One of the other things we are seeing is a lot of push, which we've heard, on loan modifications, repayments. I often get confused by the terms and what it means. We are seeing a lot more where they are still trying to push us to repayments. And they are getting stringent on the repayments, from our counselors’ perspectives, as opposed to letting it go out longer and trying to help that homeowner stay in their home.

Finally, this is one that is fairly new to me, is that when they do a repayment plan and the payment is now due on the first of the month, if they don't have it there by the first of the month, it's being emphasized to them you're in default.

We have clients who are literally sending a Western Union, incurring another $20 that they don't have, to make sure that it is there on the first of the month. Again, while I think there has been some really great progress, I still think there are a lot of very, very frustrated counselors who see clients.

We are very realistic in our agency, and we are not trying to -- there are clients that it won't work and we all get that. Even with a loan modification, we don't want to put somebody in and have them in the same situation six months later.

But when we have viable clients that we can save their home, the red tape is still

there, the rhetoric is still there. And nobody should have to wait eight months to know whether or not they have the ability to stay in their home.

MR. PHILLIPS: I just want to respond again to the question of what is going on in foreclosures and share some information with respect to our experience again in Maine.

I wanted to just build on the point that the infrastructure and capacity for foreclosure and loss mitigation and counseling is quite inadequate and how that gets addressed as many people are trying to do that in many communities.

In Maine, there has been formed what is called a MASH unit, which is made up of Maine Attorneys Saving Homes. It is a network of 25 attorneys right now in the state that have formed to help families, and their caseloads are rising. They can't keep up with that. Just to give you an example of what is coming out of the grassroots.

There is also an act in the Maine state legislature now to prevent equity stripping within the foreclosure process by making sure the ultimate acquirer of that property can't foot that and actually take advantage of some value that maybe the owner couldn't get involved in. There are some very sophisticated sort of pieces to that that we need to keep mindful of.

The last point I would like to make is building off what Alan White had said earlier in terms of the survey that had some more comprehensive credibility to it, I guess, to the extent anyone can and what is going on that the Fed here can engage in. I think that is really important.

I would like to stress if that does, in fact, take place and there is really a strong effort made to take a look at not only all these strategies but some of the data and underlying research that's driving that, that a component of that actually looks at rural impacts of foreclosure and what is going on. That doesn't get as much noticed. A lot of the concentrations are obviously in urban areas and neighborhoods, which are very obvious.

But in rural areas, which is our place of experience, we are seeing -- I think we have estimated something like 5,000 foreclosures within this period of time we're involved in, that will be in foreclosure or are in foreclosure. A lot of these families are spread out in rural communities. A lot of them are elderly as well.

You just don't see that there is an invisible part of this whole thing that's going on. So I hope if you do that survey, that the rural piece of it will also be included.

MS. ENGEL: I have a couple of quick things. One is to echo Ron's point about

not forgetting the rural areas. In Ohio, one of the areas that was targeted by a very abusive broker is the Amish community. We are seeing family farms going into foreclosure that have been in families since they came to the United States.

The second thing that goes to this whole question of data that has come up, in some people's comments explicitly and in others more implicitly, is that in the last couple of decades the mortgage industry and lenders, everybody involved, has really pushed for privatizing regulation. Now, many of the industry actors are all for socializing the remedies.

As a result of this privatization, the important numbers and important information about the market has been held by private industry. Everybody relies on FICO scores, but that material isn't publicly available. All of the information about the performance of loans and the loan terms other than the minimal amount in HMDA is held by LoanPerformance.

The information on foreclosures is held by RealtyTrac. Now we are at this point where people are turning to the Fed, and major banks in the United States are turning to the government to propose solutions to the foreclosure crisis. But they are the ones who have all the data. We don't. It is because of this privatization of the industry.

My feeling is, if they are now coming to the government and asking for our help, they need to make this data available -- data on credit scores, data on loans, data on foreclosures, loan modifications.

Short of that, the government needs to collect this data because it doesn't make sense anymore to look at the problems in this industry and make proposals if we don't have some type of foundation that is based on evidence.

MR. CALHOUN: I want to share a couple of our observations of what we've seen on the numbers and preface it by saying we are a modest-size lender and probably have credit risk on about $1.5 billion of subprime mortgages outstanding right now. So we are viewing it from both sides here.

I think maybe CRL deserves some blame for some misconceptions here and an over-focus, if you will, on the rate reset of the subprime ARMs. The point -- and I take blame for this personally as well -- was that the structure of the 2/28s and the 3/27s wasn't as much that people would not be able to afford the resets and that was going to drive the foreclosures. It was that these were never sustainable loans.

In fact, one of the factors, and when I talk with many friends in the mortgage

broker industry, that you see when you look at individual circumstances, and I know the counselors see this first, is that you look at the borrower's loan and you say, there was no way from the date this loan was originated that this borrower had a prayer of staying in this house unless they won the lottery.

Even more shocking was if you go back one or two loans before that, they were in the same boat. The brokers, they will tell the same thing, that they could tell that the borrowers were put into loans that were not sustainable for them. They could stretch it out by refinancing and in essence servicing the loan out of appreciating equity in the house, but did not have the income capacity. So, to that extent, I apologize if we have directed too much of the focus towards the reset.

Second, I think HOPE NOW and Faith's efforts are remarkable in large part because of the structural obstacles that make modifying and working out these loans difficult. You have not only the inherent securitization process, which means no one owns this whole loan anymore. People own pieces of the cash flow of a pool of loans. It’s very hard to get the parties together to do the modification.

A huge problem that we wrestle with, and I know the counselors see this, is about 40 percent of these at-risk loans have second mortgages. That just geometrically complicates the challenge of doing a workout because the second lienholder is saying, "Why should I give up my lien? Why not just ride it out and see if this is one that comes in on the money?"

The first lienholder, which is often a different party, different security at minimum, is saying, "Why should I take a haircut to benefit the second lienholder?" A lot of these first liens are getting dealt with, but the second liens are ticking bombs still out there unaddressed, and the borrower is often in still a very precarious situation.

That has led us to come around to support a controversial provision, and that is the bankruptcy modification. I guess I want to make two points on this. First, it is intended to complement and support, not be an alternative to HOPE NOW. I think Faith put it well yesterday. HOPE NOW was never intended to be the solution. All of these are going to be parts of the solution. There is not a silver bullet.

The key point about the structure of the bankruptcy reform is it actually rewards and is structured to reward and complement the voluntary modifications. To qualify for a bankruptcy modification under the proposals currently in the House and the Senate, you are only eligible if you can prove beyond the general bankruptcy restrictions that your house will be

foreclosed unless the court intervened and gave you a modification plan, and you have to show you have the capacity to handle that modification plan.

What that means, though, is that the lenders and servicers, if you will, retain the keys to the courthouse. If they offer a reasonable voluntary modification plan, the borrower will not qualify for a court-ordered modification plan. So it adds an alternative when the voluntary program is not available.

Second, the most controversial part of the bankruptcy proposal is the so-called, wonderfully described, cram-down provision, where the loans can be written down to current fair-market value.

I would note you only get the benefit of that in the bankruptcy court if you actually complete the plan, which usually is a five-year plan. If you go into the bankruptcy and don't complete the plan, you don't get the write-down of the debt. The lender retains the full amount of the lien.

We have struggled with, would the bankruptcy reform work without that. As you know, Mark Zandi has been involved in this issue, and we asked him to run the numbers. He has estimated that about 570,000 families would be helped by the current bankruptcy proposals in the House and the Senate.

We asked him to run the numbers -- what happens if you take out the cram-down. The number of families who would be preserved falls to 75,000 or 80,000. I think it reflects two things. I think the Board of Governors and Chairman Bernanke, in particular, deserve credit for the aggressive action on rates that has reduced the payment shock, and so rate modifications have less impact.

Second, the housing depreciation has been greater than I think even most people feared, and so that has put even more borrowers underwater. Chairman Bernanke's call this week for modifications of write-downs, I think, is critical. We would ask people to keep an open mind on the bankruptcy.

It's not something that we went to as a first resort or as the solution but, unfortunately, with the depth and widespread nature of this crisis, we believe it is part of the necessary array of tools that need to be brought to this.

MS. BRIDGES: Ed.

MR. SIVAK: Some of this is going to be in the form of a question, and some is

going to be rehashing conversation yesterday. Sarah brought up the notion of a moratorium and sharing that if there is, in fact, a moratorium that's going to happen, there is an outcome that happens at the end of that action.

The question that I raise is, is there an opportunity to do a moratorium in conjunction with some systemic loan modifications based on certain criteria of certain loan classes -- whether they are subprime, adjustable -- and then understanding there is obviously legal risk associated with this as well but trying to be real intentional about trying to figure out and isolate what those are so something can happen again on a more -- at a larger scale than what's going on.

The notion of the moratorium was discussed by people with servicing experience in that as things are backing up and if you look at the projections in terms of what's still coming down the pike, if there was some way to do some systemic modifications and just allow some time to catch up, that would stay a lot of the foreclosures cases which are on the desk of many servicers, which they may not be able to get to in the time that it's going to take before that action occurs. So, again, the question is, is there a possibility for some systemic loan modifications and what does that look like?

MS. BRIDGES: Thank you.

MR. WHITE: We had an experience in Philadelphia with a kind of a foreclosure moratorium in 1983 and a tax sale moratorium in, I think, 1999. The same issue arises -- if you are going to hold off foreclosures for some period of time, you want to have some kind of an outcome.

Secretary Paulson announced this plan, and I think the HOPE NOW servicers have signed on to some extent, to delay foreclosures voluntarily for 30 days for people who contact their servicer. The difficulty with that is what we've heard from Patty and others -- that you are not getting a response to your loss-mitigation request in 30 days.

It strikes me that an intermediate step, at a minimum, is to try in some very public way to announce that servicers are willing to commit to stop foreclosure for the amount of time it actually takes to actually respond to the homeowner given current data on what those response times are, which I assume can be measured.

If it's six months, then the stay should be for six months. If it's 90 days, it should be for 90 days. If the servicers will commit that they will stop foreclosure in any case where somebody requests a loss mitigation and does a reasonable amount of follow-up, provides the information they are supposed to provide, it strikes me that that would be a first step. And you don't

necessarily have to call it a moratorium because you are not going to include totally nonresponsive homeowners, the ones who are walking away and the investors and so forth.

I think there has to be a move to that, and the sooner the better, because right now we do have this pipeline problem. You have all these foreclosures coming into the pipeline, and servicers who don't have the staff to answer the phone, let alone review all these financial statements and make decisions.

Then you have further problems with re-defaults and failed repayment plans that need a second look maybe. It strikes me there is some kind of intermediate solution which goes well beyond the Paulson 30-day hold notion and maybe falls short of a national moratorium on all foreclosures that would be a sensible thing to do and save potentially millions of homes and billions of dollars.

MS. LUDWIG: Just a quick point, a little more perspective from the ground, and picking up on something that Mike Calhoun was saying. A lot of the discussion around the foreclosure crisis and around subprime lending really centers on the reset issue. If that were our only issue, that would be one thing. But a very large percentage of the dots on this map represent homeowners who didn't have a resetting mortgage, although it is obviously a big component, but who had nontraditional mortgages.

So I want to underscore something that I raised earlier about the coverage in the HOEPA reg, which is that we really need to make sure we don't have a big hole in the regulation where nontraditional mortgages sit and that we understand that it would be very easy to manipulate the threshold through some of the ways that the nontraditional mortgages are constructed.

We want to make sure that doesn't happen because it's just been a very, very large problem and continues to be. Even though we talk about a much shrunken market, a big portion of that.

MS. BRIDGES: Mr. Chair, I'll turn it back to you.

CHAIRMAN BROWN: Kick it back to me. Let me thank everyone for their very thoughtful debate on these issues. To Joe, Mr. Falk, I want to say that you were typically your eloquent and articulate self, and your industry should be proud.

While Ed is setting up, I'm going to introduce Ed. As you know, at each of our meetings we have a Members Forum, and it is the opportunity to hear from Council members on programs and initiatives at your institutions, organizations, or within your communities. Ed has

agreed to provide us a brief presentation on his organization.

Ed Sivak is the director of Policy and Evaluation at the Enterprise Corporation of the Delta. As director, he runs the Mississippi Economic Policy Center, a public policy initiative that informs the public on issues that affect the economic and social well-being of working families and low-wealth Mississippians.

Ed also manages several of ECD's community development projects including the Collaborative for Enterprise Development, which is an effort funded by the Louisiana Disaster Recovery Foundation to rebuild small businesses and entrepreneurs in New Orleans.

Ed is the council secretary for BancorpSouth's Community Reinvestment Advisory Council and a board member of the Mississippi Low-Income Child Care Initiative.

Ed, if you're ready, I'll kick it to you.

MR. SIVAK: I'm ready. Thanks a lot. I really appreciate the opportunity to tell you a little bit about our organization. I've been there for just about seven years. I started as an intern, and it's a place where I am really proud of the work that we do.

Enterprise Corporation of the Delta, ECD, started in 1994. It is a community development finance institution. We are certified by the Department of Treasury. We really started out working on providing small business loans to businesses that couldn't get financing from banks in the Mississippi Delta.

Over time, we have grown to also provide mortgage services and personal financial services as well through HOPE Community Credit Union. HOPE was chartered in 1995. It is the only church-sponsored credit union in Mississippi. Again, we offer nonpredatory financial services to low-income, low-wealth people.

We have over 9,000 members. A lot of those members joined our credit union after the hurricane. We were very fortunate that the branch in New Orleans was in an area of town where it didn't get a whole lot of water, and we were able to get back on line pretty quickly and serve the folks there.

I want to tell you about the innovation that really allowed both of these two organizations to come together and grow. ECD was very successful early on raising capital for its lending activities largely from philanthropic sources. Obviously, that is not a sustainable capital-raising strategy over time.

HOPE was a small credit union. I can remember back in '02 working on the

low-income tax preparation program. They just had one branch. It was in the medical mall, lower-income part of town, in a room not bigger than the dining room where we'll go eat. We offered signature loans, auto loans, and savings accounts, and that was essentially the extent of it.

What we did was ECD needed capital, and HOPE obviously wanted to offer more to its members. We were able to take the New Markets Tax Credit program. It was a new program at the time through the U.S. Treasury's Community Development Financial Institutions Fund. We found $15 million. Investors invested $15 million into the tax credits.

Then we used the investments from those credits to make a secondary capital injection into the credit union. What this allowed the credit union to do was to raise deposits. So, essentially, we recognized that banks got it right. You can raise your own capital through raising deposits.

So what this did -- the membership voted to make ECD its primary sponsor, and now the members of the credit union could get mortgages. They could get small business loans. And ECD had a way to raise capital as well.

I broke every rule in PowerPoint etiquette by putting this slide up there, but I knew you all would have handouts. The things that we do -- you should look at the handouts. There is commercial lending, small business loans. Minority and women-owned businesses are a big emphasis of what we do. Mortgage and consumer financial services, community development partnerships.

I'll just give you a quick example. We manage the Collaborative for Enterprise Development, which is a group of six nonprofit organizations, each with different competencies. Some do small business credit counseling. Some provide loan capital. Some provide technical assistance.

We take entrepreneurs in New Orleans and try to meet them where they are and collectively get them back on track in the post-storm environment.

Hurricane recovery rebuilding. ECD/HOPE was selected to provide counseling to every grant recipient of a hurricane recovery grant through the Phase II program. What this is is anyone who is low-income and in the flood zone down the Mississippi Gulf Coast, they qualify for a recovery grant after meeting certain criteria.

We provide counseling. What that means is we sit down with them and look at

what their grant amount is going to be. We look at any insurance they may or may not have and do an options analysis and say, "Based on the money you have, you might have to rebuild your home. It might have to be 200 square feet smaller or you can rebuild what you had before."

We sit there, and we build that relationship, and they can come back over time as well. If they are working with the contractor and have questions about it, they can come back and meet with our counseling team there.

We do a lot of policy advocacy. This has largely been supported through our lending activities. The fact that we have been able to do lending in places like the Mississippi Delta successfully enhances our credibility to talk about different programs. For example, a few years ago we got a statewide New Markets Tax Credit passed.

We also do a lot of work on budget and tax issues, recognizing that you need to have a strong, healthy tax system to ensure that there are strong systems in place to make sure people can move up the economic ladder. And we take on socially responsible investments.

At this point, I'm going to transfer over to -- we have a video where you'll be able to see some of our members in action. I really appreciate it again, and thank you for allowing us to show this. I think it will be great to again see the members and the customers who we serve.

(Whereupon, the video was played.)

MR. SIVAK: Thank you again for allowing me to share that. I really appreciate it. Some of the comments I make you can take or leave, but fundamentally the comment I made about the presence or absence of assets being how we are going to deal with poverty in America, that is at the core of what we believe in at ECD/HOPE.

We've served about 35,000 people since 1994. That's a drop in the bucket relative to the needs of this region. What Bill says all the time, my boss, and you saw him there, "The financial institutions can take this stuff to scale, and if we are going to build wealth in communities we have to do it together." Again, thanks and look forward to eating lunch with you all.

CHAIRMAN BROWN: We are going to go quickly through the rest of the agenda. The item that's up next are the committee reports. We are going to ask each of the committee chairs to provide a brief report on the work that they accomplished yesterday but, more particularly, to talk about what the plans are for future meetings.

I'm going to call on Mark Metz first for Depository and Delivery Systems.

MR. METZ: Thanks, Tony. We had a very good discussion on the proposed rules and guidelines for furnishers of consumer information for reporting agencies. It got into sort of the difference of whether the rules should be regulatory or guidelines. We had a very good discussion around that.

We also talked about best practices for garnishment rules. Then finally the Internet Gambling Enforcement Act. We actually ran out of time, and a couple of topics that we are going to cover in the future -- the first one is the FACT Act and hopefully the proposed rules on risk-based pricing will be available. We would like to discuss that. Then we also will touch on BSA and then maybe one or two other topics.

CHAIRMAN BROWN: Thanks, Mark.

Mr. Falk would like us to turn the heat on to Consumer Credit. On that note, Faith, would you --

MS. SCHWARTZ: Don't worry, Joe.

There are a number of items we discussed with some overlap to what Mark has mentioned. The new proposed rules on credit card practices, closed-end credit review, HMDA data. There was some discussion that maybe we could have a preview of the fall data release or some kind of commentary.

HMDA enforcement. That's just been around on our committee to talk through what's going on with what you are finding out through the HMDA data. And, of course, risk-based pricing. Those were our key issues. Thanks.

CHAIRMAN BROWN: Great. Compliance and Community Reinvestment. Dorothy.

MS. BRIDGES: The biggest discussion, of course, was the mortgage foreclosure and some of the initiatives that were going on in the community. We also talked a little bit about community reinvestment initiatives, particularly in the servicing and investment tests for financial institutions, as well as the 30-year anniversary of CRA.

We did also have but didn't have an individual to speak to us regarding efforts in Cleveland, Ohio, concerning mortgage foreclosures. We had a very, very good presentation by Beverly Smith of the staff on minority-owned financial institutions and some of the efforts that the Fed is exploring to help strengthen and sustain those institutions in our communities. Coming up for the next committee discussion, there were several topics --

CHAIRMAN BROWN: Dorothy, put a mic up to you, please.

MS. BRIDGES: Sorry. Coming up at the next meeting, we are going to talk about the underpinning consequences of BSA and how it is affecting our ability to serve the new immigrant population. Sarah Ludwig on our committee had some very, very exciting things to encourage us to discuss.

We're also going to talk about reverse mortgages, global banking issues, and the importance on the regulations. That was brought up by staff. Then we are going to talk a little bit about banking fees and the structures of those fees and how they get disclosed from the banks to the consumer. Then also we are going to explore a little bit about some updates on additional strategies around the mortgage foreclosure issue.

CHAIRMAN BROWN: Lastly, Ed again, Community Affairs and Housing.

MR. SIVAK: Sure. In our committee, we talked about everything we talked about today. Next time we are going to talk about foreclosure rescue scams, foreclosure loan modification strategies, what can be done with REO properties, resources for community development.

Then we really want to dive into the data discussion -- what can be made available, what's needed, how can we use the opportunity to be here with the Fed to see what else can be put out there for public consumption and analysis.

CHAIRMAN BROWN: Thank you. Our next meeting is in June, and we will have full agendas for that meeting. In closing, I would like to thank everyone for their participation today. As always, the conversations were lively, and a range of opinions were aired.

Just as a reminder, we are asking the Council members to remain here as a group. We will be taking pictures. After that we'll move to Dining Room L for lunch. Thank you.

(Whereupon, at 12:53 p.m. the meeting was adjourned.)