TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING
THURSDAY
JUNE 27, 2002

The Council met at the offices of the Board of Governors of the Federal Reserve System, Washington, D.C., at 9:00 a.m.

Members present:
Dorothy Broadman, Chair
Ronald A. Reiter, Vice Chair
Anthony S. Abbate
Janie Barrera
Kenneth P. Bordelon
Teresa A. Bryce
Manuel Casanova, Jr.
Robert M. Cheadle
Robin Coffey
Lester W. Firstenberger
Thomas P. FitzGibbon, Jr.
Larry Hawkins
Earl Jarolimek
Ruhi Maker
Oscar Marquis
Patricia McCoy
Elizabeth Renuart
Benson Roberts
Agnes Bundy Scanlan
Russell W. Schrader
Frank Torres, III
Hubert Van Tol

Others present:
Dolores S. Smith, Director, Division of Consumer and Community Affairs
Edward M. Gramlich, member, Board of Governors
Susan Schmidt Bies, member, Board of Governors
Mark W. Olson, member, Board of Governors

AGENDA ITEM	PAGE
MEETING CONVENES (Announcements)	3
PRIVACY RULES	3
COMMUNITY REINVESTMENT ACT	25
FINANCIAL LITERACY	48
MEMBERS FORUM	62
COMMITTEE REPORTS	77
ADJOURNMENT	80

PROCEEDINGS

(9:00 a.m.)

MS. BROADMAN: We are ready to convene the meeting if everyone would please be seated.

Good morning and welcome. Just a reminder that you are not to touch the microphones. Just speak naturally and you will be heard.

Before we start, I would like to welcome Governor Olson to our meeting, and also a special welcome to Governor Bies. Thank you for joining us. This is her first meeting with the CAC. We very much appreciate your attendance and look forward to your comments.

PRIVACY RULES

MS. BROADMAN: We will start the meeting today with a discussion on privacy and that will be led by Russ Schrader.

MR. SCHRADER: Thank you. Thank you and good morning.

As many of you are aware, the Gramm-Leach-Bliley Financial Modernization Act of 1999, which was originally passed in order to facilitate the affiliation of banking, securities and insurance firms, has a title devoted to privacy, and I think among our group, that particular title has received at least as much attention and time and press as other provisions of Gramm-Leach-Bliley, and in particular Regulation P, the regulation implementing some of the privacy notices.

It has been a year since Regulation P and the first set of notices has taken effect and what we discussed yesterday at our meeting we would like to discuss today, is a little bit -- now that we've had one experience in going through the notices, how are the rules working? Are banks sharing information? What percentage of people seem to be opting out? And how effective are the notices and the Regulation P requirements and protections?

We had a vigorous discussion and several excellent points were made, so I would like to start off the discussion by asking some of our members to recap some of the points made and then bring in the entire committee for a broader discussion as time permits.

To begin, I would like to ask Agnes Bundy Scanlan to kick off and talk about what experience she has had.

MS. BUNDY SCANLAN: Great. Thank you. Thank you, Russ.

It is very hard to tell exactly how the rules have progressed over the last year. It's still very new. However, financial institutions in general really have performed well working with

focus groups, working with consumer organizations, to comply with Gramm-Leach-Bliley. Post-July 2000, I think the concern that was raised over the readability, the legalese in these notices, the lengthiness, it was further brought to mind by the December 4th workshop that the interagencies conducted.

I think what we will see in the notices that are coming out now is that there is marked improvement. I think that there is not much disagreement that the notices need to be more consumer-friendly and that it was a very complicated process.

MS. BROADMAN: Excuse me, Agnes. I am getting the word that it's difficult to hear you, so if you could just speak a little bit louder.

MS. BUNDY SCANLAN: Yes, I will.

I think that what we are finding is that there is no disagreement that the notices were, indeed, very complicated and difficult to read, but I think we will find that this year, the notices are looking much more improved.

I don't want people to forget, however, that this is a legal document and that we must ensure that this contract between a financial institution and a consumer organization is as such.

In terms of banks sharing information, a few institutions have said in their privacy policies that they are not going to share information outside of their organization to third parties. Some institutions do say that they may share information so that they are allowed the opportunity to do so if they decide, but in fact, many of those that use that term "may" don't really share inside their organization, but they want to allow for the right to do so.

In terms of what people are opting out or what the percentage or number of opt-outs are, these notices, between one billion or even a trillion, as some people have said, that did float around and were mailed out last year, there were a lot of notices; however, what we're finding is that there is not a lot in terms of a high number of people that opted out. It seems like there is a very small percentage.

I do encourage both financial institutions and consumer groups and also the regulatory agencies to continue to work together to try and create a template or a short notice that institutions can work toward to try and make them more customer-friendly. Certainly using the focus groups, the institutions have been reviewing their privacy policies. I think we should just take a moment and just let the second round of notices proceed to see how we might go forth.

MR. SCHRADER: Thanks.

Ron, we're going to move from the East Coast with Agnes to the West Coast. What has been the experience you have seen in California and working with the people there?

MR. REITER: Well, in talking both with consumer groups and with other agencies that have been involved in this area, I think there has been overall a level of disappointment at the type of some notices that have gone out. The notices have been unduly sort of dense and prolix. Because they are difficult to read, sometimes the format is difficult, small print, small pieces of paper, it has been difficult for people to really understand what the notices provide; and because the format is so uninviting, many people, of course, don't even bother to read the notices or toss them aside.

I think that experience generally is that notices that are going to receive any degree of consumer response have to be made in both simple language, language that reflects the reading level of the average consumer, and that the method of communicating back to the bank is sufficiently simple that people can actually effectuate the notice and express their intent.

We've seen instances where financial institutions require consumers to write their account number on separate pieces of paper, so if they have multiple accounts, they have to fill out multiple forms and then prepare their own envelope and send it back, et cetera. The more steps, the more tasks that you put before a person, the less likely you will have a decent response. This is sort of common marketing, and it does seem that the notices are not well designed to elicit a substantial consumer response.

So I think that many people in the consumer community, many people in law enforcement who are interested in protecting privacy rights would certainly advocate a more concise notice, the use of plain language geared to the typical consumer, a clear explanation of the types of information that may be shared and how consumers can exercise their rights, and then to provide a mechanism for the exercise of those rights that is simple.

MR. SCHRADER: Thanks.

Now, Larry, you actually had an interesting point on some of these notices as well.

MR. HAWKINS: It's going to be interesting to see what the response is going to be with this very simplistic language that you talk about.

Consumers are inundated with so much information, with so much junk mail --

not saying that this is junk mail, but it's difficult for them to discern, you know, what they should really be looking at and what they should not be.

You know, I believe what's going to happen is that you will get similar results that you would get like if you talked about, say, advertising, and even people that do advertising in a very proactive way to try to get consumer interest -- let's take the automobile dealers, the manufacturers, for example, that do a lot of advertising. Well, those of you in this room, when is the last time that you paid attention to an automobile ad? Well, you probably haven't unless you were interested in buying a car. So with all the advertising that they do, even maybe there's a 1 percent response, and I believe that essentially what we're seeing here is maybe not so much the complexity of the format, but it's just that consumers are so inundated with so much that they just tend to brush a lot of it aside unless there's a real immediate need or interest that they have.

MR. SCHRADER: Now, Teresa, you made a point with the information-sharing practices as well.

MS. BRYCE: Well, there have been a lot of discussions about whether or not the whole concept of opt-out is adequate and whether there should opt-in, particularly with respect to affiliate sharing and one of the concerns is that a lot of that then falls to the structure of a particular company.

So, for instance, a large financial institution that has mortgage lending within the bank structure doesn't have any issue with taking information from, say, the depository side and sending mailings out or sharing that information with the mortgage division, but another company that for various regulatory reasons may have a separate mortgage company would not be able to do the same thing, and that doesn't seem to make any sense.

I believe that a consumer who does business with a particular financial institution has an expectation of having services from that financial institution offered to them regardless of the affiliate structure within the institution.

MR. SCHRADER: Frank, you had some good comments yesterday.

MR. TORRES: Yes. And I know that we had a very rigorous discussion yesterday, and actually, after having slept on this a little bit last night, some of my feelings have changed somewhat.

I felt yesterday, hearing the discussion with a lot of my industry friends sitting around this table, that I was almost having to defend Title V of the Gramm-Leach-Bliley Act which

dealt with the privacy protections and the ensuing regulations, and actually, I have to constantly remind myself that the consumer community and the privacy community thought that the Title V provisions were actually grossly inadequate. I've got my own theory, perhaps, of why we have such a low response rate, and that is either -- a low response for one of two reasons.

The first reason is, as people stated, the notices were confusing, difficult to find. As Larry said, they got kind of thrown out in the junk.

A second reason is, if a consumer actually got one of these things and understood what it said and realized that the opt-out choice that he was being given didn't really opt him out of too much of anything, he probably wouldn't have taken the time or trouble to fill this thing out. There are so many loopholes in the law, in the underlying law that, you know, basically the underlying problem with the Gramm-Leach-Bliley privacy protection provisions is it really doesn't protect privacy.

You know, we were talking yesterday and I guess I'm supposed to be commenting on ways to improve it, and I think that the notices could be improved, but they will always be fatally flawed. We thought that it might help consumers to get these notices by making consumers realize how their information was being shared. Some companies have hundreds of affiliated companies and we thought it might be helpful for consumers to know that. But because you can share it with any affiliates, any third parties with whom you have servicing agreements with, I mean, perhaps the best thing we could do is just have a notice wherever we can get it in as big font as we can get it just to say, "We're your financial institution. Any information you share with us, we can share with basically whoever we want and for whatever reason we think it's appropriate for you."

So maybe what I'm getting at here is instead of raising false privacy protection expectations amongst consumers, we need to consider maybe even dumping or getting rid of Title V all together of the Gramm-Leach-Bliley Act. It really doesn't do that much good for consumers and we spent a lot of time and I know companies have spent a lot of money trying to pursue complying with the law and regulations.

MR. SCHRADER: Lester, you had your hand up?

MR. FIRSTENBERGER: So your biggest complaint is with the statute, not with the rules. Would you say it's a fair statement: The rules implement the statute fairly and accurately?

MR. TORRES: The rules implement the statute fairly and accurately. The way they got interpreted, I don't think the rules were meant to allow for the notices the way they came out to be so -- let me state it another way. There is nothing in the rules or in the law that would have prevented a financial institution from simplifying the notice that went out to consumers.

I know that you all insist that you had to provide some legalese, and that's fine, that's well and good, but -- and the argument that I made yesterday was, imagine this was an opt-in where you had to -- where a financial institution had to convince a consumer to give you permission to share their information. We would have seen the most brilliant marketing campaign, you know, bar none, to convince consumers to share their information. Instead, we've got a lot of legal gobbledy-gook that --

MR. FIRSTENBERGER: But opt-in is not the law. That is the law in Europe, but it's not the law here.

MR. SCHRADER: Governor.

GOVERNOR GRAMLICH: I just have a question of all of you. Recognizing -- actually, I touched the microphone. Is that okay?

(Laughter.)

GOVERNOR GRAMLICH: Recognizing that we can't change human nature and we can't change economic incentives, and if you want the law changed, you have to see our friends on the other end of Constitution Avenue, are there practical things that the Fed ought to be considering doing about this? I haven't heard too much of that.

MR. SCHRADER: Well, Elizabeth, you had some practical suggestions.

MS. RENUART: Well, some of the things I thought of that sort of augment what Ron was talking about, and I certainly are tell my colleague Frank on the underlying philosophical issue about opt-in or opt-out, but putting that aside, there should be a tear-off or separate card so that when you are allowed to send it back, it's a separate piece of paper with none of the other disclosures on it.

Some of the notices I received had the so-called privacy information and it was part of the tear-off piece of paper, so I couldn't keep that information. If I was going to tear it off, it went back to my company and I didn't get to keep it. So that was a glitch.

So I think there should be a separate card, and it could be -- well, just a separate piece of paper or card that you would just sign and check off whatever you need to and put your

account number and send it back.

Another problem is subsequent notices. The notices have to come out on an annual basis, and it's confusing to consumers as to whether, if you've already opted out, whether that means you have to opt out again or whether your first opt-out gives you a continuing right to not have your information shared. So any subsequent annual notices should say, "If you've already opted out, you don't need to do it again."

If the policy has changed -- for example, a financial institution could have told you in an earlier notice that, "We share with affiliates, but we don't share with other third parties," and they change that policy, now they are going to share with third parties, there should be a title on the notice saying "New Privacy Policy," whatever that is, so that I would know, oh, well, that's different from the last one and if I want to opt out, I would want to opt out again rather than assume that my prior opt-out was sufficient.

MR. SCHRADER: Thanks.

Now, Earl, you wanted to say something, too?

MR. JAROLIMEK: Yes. I just -- you know, an observation I had with the whole discussion about the length of the privacy notice that was sent out by there any financial institutions was a lot of it, I think, the length -- what contributed to that was the requirement to describe the structure, all the companies that make up or affiliates that make up a company. I think that certainly contributed to the length, but that is something that certainly was needed and required.

You know, I think, Governor Gramlich, you know, your question -- or to your question, what practical things might the Fed consider, you know, as Agnes pointed out, I think bankers have contributed a lot in forums and discussions about how we can simplify the notice, make it more readable.

One of the things that I think most of us did a year ago when we first contemplated our notice was to look at the model language and try to stay within whatever parameters we thought that was offering us as a form of some protection, and after these discussions and forums and when we realized that simplicity may be not only good for our customers, but good for everyone, you know, would the Fed and other agencies consider some level of assurance that, you know, we might be able to go into a simplified notice with some degree of protection or eliminate some of the uncertainty, because, you know, we're relatively conservative by nature, and the legalese, I think, was result of a lot of the model language.

MR. SCHRADER: Patricia?

MS. McCOY: Thank you, Russ.

I think one empirical question that remains is what is the reason for --

MR. SCHRADER: Can you just speak up?

MS. McCOY: I think many of us have intuitive senses as to why that is, but the senses may not be right. We discussed the difficulty of reading the forms. There are, as Ron has mentioned, true difficulties with some bank holding companies in opting out. I have had personal experience of a bank holding company which I telephoned an 800 number and they actively tried to talk me out of my opt-out rights. So I see that hard sell marketing as a problem.

But furthermore, there is a reason why originally in the passage of Gramm-Leach-Bliley there was a big fight over opt-in and opt-out, which is that the choice between the two allocates the difficulty of exercising the right, so that if there is an opt-in right, as Frank has pointed out, the difficulty of making sure that people agree to sharing is put on companies, and we don't know whether the reason that people are not opting out is because they don't prize privacy or because those difficulties are too high.

So one empirical study I would like to see is to compare experiences between opt-in regimes and opt-out regimes, and we now have one or more states that are opt-in to form a basis of comparison.

I am also told by some of my colleagues who are privacy officers that there few banks that actually do have opt-in regimes, and again, it would be interesting to identify those banks and find out their experience.

The final empirical question I would also be interested in is whether or not we can place any monetized value on privacy rights. I think that would be very interesting for financial institutions to know.

Thank you.

MR. SCHRADER: Thank you.

Anthony, what was your experience as head of a small financial institution on the response rates and so on?

MR. ABBATE: We mailed out 56,000 pieces and 13 people opted out, which is less than 1 percent. But I have to say that that is the experience that you get with direct mail marketing. When we direct mail market to our existing customer base, if we get a 1 percent

response, that's considered excellent, and so I don't think that it's all that terrible.

You have to also recognize that opt-out was a vehicle or solution for those people that didn't want to be cross-marketed, so if that were the case, then those people that responded were those people that desired not to opt-in.

I would also like to say that although the regulation didn't mandate a particular format for the construction of the opt-in and opt-out form, I think it would be very helpful if we had a template or a format to follow that would give you some latitude, naturally, to be able to communicate with those people that they would understand exactly what the form was all about, but also that the opt-in, as Elizabeth suggested, would be simplified so that people who wanted to take advantage of it could readily do so. I think that the difficulty we have here is the way we communicate the privacy notice.

MR. SCHRADER: Frank.

MR. TORRES: Yes. Just to follow up on that and to your question, Governor, we completely agree that a template, a standardized form would be useful both for some of the concerns we've heard from the industry as well as to get consumers kind of more geared to looking at this.

In addition to Elizabeth's comments, something that was brought up during the discussion of the Gramm-Leach-Bliley Act was, is there a way for consumers to be able to shop on the basis of privacy? I mean, I don't know if there's anything out there today that enables a consumer to compare one financial institution's privacy policies with another, and by perhaps standardizing the format a little bit, somebody could do that comparison; if not the Fed, perhaps somebody else.

GOVERNOR GRAMLICH: Just on that, I know that in the regs that we put out, we had modelled privacy forms, so you're saying these aren't adequate in some ways?

MR. TORRES: I think, you know, perhaps one suggestion would be to have a discussion, a serious discussion between the privacy community, other interested parties, certainly the financial institutions, and perhaps to lock us all in a room and come up with something that could work that makes sense.

MS. BUNDY SCANLAN: That may take forever.

MR. SCHRADER: Oscar?

MR. MARQUIS: Well, I think it's a very interesting discussion. The notices are

inevitably confusing because the law is confusing. Under Gramm-Leach-Bliley, Gramm-Leach-Bliley deals with affiliate sharing or non-affiliate sharing. There is a Fair Credit Reporting Act notice that deals with non-affiliate -- with affiliate sharing. One deals with all information; the other deals with transaction experience information. It's inevitably -- it's inevitable that the notice is going to be confusing.

The response rate, as has been said, if it's opt-in or if it's opt-out, is going to be low because consumers don't opt; they just don't -- they don't respond to offers, they don't respond to marketing offers, if it's free miles, if it's free anything, the response rate is about the same as the response rate for opting out. So you can't really, I don't think, get a larger response rate.

In terms of making it easier by having a tear-off envelope or tear-off postcard or something, if consumers really care about their privacy, writing a little note or making a -- spending 34 cents on a postage stamp, or 37, whatever it's going to be, doesn't seem to be that serious an obstacle if consumers really care.

But I think what we need to remember is that what does direct marketing do? The alternative to direct marketing is mass-marketing, it's more commercials. Does anyone like more commercials on TV and on radio? Do you like fatter newspapers with a lot more ads? The alternative to direct marketing is mass-marketing, and what direct marketing does, and it's targeted marketing, is increase your choices.

Consumers have credit cards because they got a direct marketing offer. In the old days, you used to shop for credit by going to the local bank and picking up take-with applications and comparing rates at the local banks. Now you have national banks competing for your business because you haven't opted out.

We heard yesterday a report about sub-prime borrowers and that credit bureaus often don't get information from sub-prime lenders about the best sub-prime customers. The theory is that other banks will then solicit the better sub-prime borrowers and offer them better rates. Well, if they opt out, they won't get those offers, they won't get those choices.

So you can improve the mailings, you can improve the notice, but why are we promoting or why is the government promoting, why are regulations promoting lack of consumer choice? Consumers Union, for example, is a direct marketing company. You can't buy Consumer Reports at the newsstand; you get it when they send you a direct marketing offer --

MR. TORRES: That's not right. You can buy it at the newsstand.

MR. MARQUIS: Okay. Well, you couldn't the last time I looked. Which was five years ago.

(Laughter.)

MR. MARQUIS: But it's primarily a direct marketing publication, and it has an opt-out notice and the magazine. That's the way -- that's the best way to reach consumers, and the alternative is mass-marketing, which has its drawbacks.

MR. SCHRADER: Agnes, you had your hand up.

MS. BUNDY SCANLAN: With regard to Pat's comments about opt-in experience and comparing that with opt-out experiences, our institution has a privacy policy of not sharing information outside the family for marketing purposes, and we sent out 24 million notices this year, about the same number last year, and the response rate has been low both times, less than 1 percent. I know of some informal studies by some of the major institutions. I received a call the other day from a colleague at J.P. Morgan Chase, and when I told them about our response, it was very similar to theirs, and I believe they have a policy of sharing.

So I don't know what the formal studies would show, but informally, I don't believe that there is that much of a difference, at least from some of the major institutions.

In terms of Earl's comments about protection, we have undergone a privacy examination by the regulators. A lot of time was spent on how we developed the privacy policy, how it complied with Gramm-Leach-Bliley, looking at the actual model language, looking at the requirements of Gramm-Leach-Bliley and how we put that into our privacy policy. So if we are going to a template, if we are going to do something different, we do need some sort of guidance from the regulators in terms of protecting or what we can put in our privacy policy, and that would, indeed, be in compliance with the law.

MR. SCHRADER: Okay. Manny.

MR. CASANOVA: Yes. I just had a question for Anthony.

That experience that you had, I guess you had 54,000 letters that went out and the response was, again, how many?

MR. ABBATE: Thirteen.

MR. CASANOVA: Okay. Out of the 13, what kind of monitoring has to be done there? What kind of burden does that create for you?

MR. ABBATE: I can't answer you. I don't know what the burden is.

MR. CASANOVA: Okay. I was just curious about that.

MR. SCHRADER: Teresa? You've been patient.

MS. BRYCE: Just a couple of follow-up points, one to Frank's point about being able to shop privacy policies. I know everyone doesn't have access to the Internet, but I believe most financial institutions have Internet sites and the privacy policies are on those Internet sites. So there really is an opportunity to go and look at privacy policies and compare them.

The other thing I wanted to just mention is that when the Gramm-Leach-Bliley was passed and the whole discussion of privacy notices, there was a huge amount of media attention to this issue, a lot of articles about whether it was adequate or not adequate, et cetera, and so I just want to underscore the fact that when these privacy policies went out a year go, there was a lot of media, and I think most people should have known from the newspapers and the news reports that these things were coming to them.

There was also some discussion about whether or not it should be included in a mailing or not. I think some of us did do a separate mailing of the privacy policy, didn't include it in a billing statement or any other type of statement, and still saw less than a 1 percent rate of response on those.

MR. SCHRADER: Thanks.

Larry, you had your hand up?

MR. HAWKINS: Yes. Just a question. How would you define success? What percentage return would you want to say, hey, now we've been real successful? And candidly, do you believe that you can really achieve that no matter what you do? And if you don't believe you can, what changes should the Fed be making?

MR. SCHRADER: I have a waiting list, but go ahead, Dorothy, we haven't heard from you.

MS. BROADMAN: I'll get in line. That's fine.

MR. SCHRADER: Okay. All right. In that case, Ken's next. Sorry.

MR. BORDELON: Well, I might try to answer Larry's question.

(Laughter.)

GOVERNOR OLSON: Is this a WorldCom mic?

(Laughter.)

MR. BORDELON: I would like to refocus, I think, some of the attention to the

financial institutions and credit unions in particular that it's not just a legal document, but it's a trusted member relationship that we have that we're trying to protect. We are going to protect our members' privacies, and if you don't believe that, that's what our competition is after, is that trust relationship. If we violate that privacy, we're going to lose that relationship. So it is very, very important. In fact, in our federal bylaws, it's a standard restriction to share that type of information.

We too had less than 1 percent participation in our mailings. I had only one member e-mail me and he was very appreciative of getting a notice for every child in the household from three credit unions.

(Laughter.)

MR. BORDELON: But without, Governor, modifying the law, I think the consensus in our group was that a federal template or something simple would be nice, but then you have conflicting state laws, and without modifying the law for some federal preemption, we don't see that there is any hope for any simplification.

Finally, the reality is, I would like to think that privacy and literacy are basically a little bit intertwined here. I would like to report better rates, but we estimated only 20 percent of our members open their monthly statements, and only twelve percent actually balance them, and fewer actually read the monthly newsletter, and that may be because balances are more readily available through audio response, through Internet and that type of activity that they don't feel the need to get information more frequently.

So, you know, that has been our experience, and I don't know what a good success rate would be, Larry. That's a good question.

MR. SCHRADER: Pat.

MS. McCOY: Sometimes in judging the effectiveness of disclosures, I like to poll my law school colleagues because ostensibly they are highly educated and used to reading disclosures. But in fact, on Gramm-Leach-Bliley, what I found was they did acknowledge they had received some sort of disclosure, but they had no idea what prompted it, and that caused me to think that despite the marketing around the privacy notices, we might be able to do a better job of telling consumers, this is a notice that triggers an opportunity for you, and my law school colleagues were not understanding that.

The other thing was that most of them did not read to the end, and I imagine all of us know in this room that the first part of the notice you should read is the end because that tells

you your rights in terms of what you can act on. So we might want to, as we fashion the new standard template, which I do think is a good idea, at the top of the template, say, "Read for important opt-out rights" to alert people that there's something they can act on.

MR. SCHRADER: Thanks.

Ron, I think you're next.

MR. REITER: Just a fairly simple point. We've had a debate here today about what is the explanation for the low response, and it can be anything from consumer apathy to the prolixity and difficulty of the notice itself, to the fact that people are overjoyed to have their personal information shared with others so that they can get the opportunity of new offers, whatever it may be, but there hasn't been much in the way of empirical research as to what sort of notice is best geared to the average readability level of the country, there hasn't been any evidence as to sort of test-marketing these notices and focus groups, the kinds of things that would be done with the sort of enhanced marketing effort that Frank was talking about if this was an opt-in rather than an opt-out procedure.

So I guess one of the questions is whether we can have some simplified research, perhaps even the Fed's research staff conducting some surveys or doing something to figure out what would be the best form of notice so that it could be simple, not costly for the financial institutions, provide as much of a template as possible, provide the safe harbor protections I think that Earl may have been alluding to a little bit earlier that banks could send these out without fear of lawsuits and liability, and that consumers would have better information, and then consumers are now presented with an opt-out choice, and either they would exercise it or not, but at least we would have a level of confidence that the best effort was being made to communicate the information and give them a reasonable opportunity to respond.

MR. SCHRADER: Governor, you jumped to the top of the list.

GOVERNOR GRAMLICH: Just another question. Would this simplified template that a lot of you are talking about, would you have in mind something like a Schumer Box for the privacy notice, I mean one place where the essential information is there? You still have all the disclosures and the legal required language in the rest of it, but you could quickly see the key things in this one little box? Would that be the kind of thing?

MR. SCHRADER: Oscar?

MR. MARQUIS: Well, I think that's a good idea, and the Center for Information

Policy Leadership, which is a part of my law firm, has developed a project working with some major financial institutions and they have come up with a simplified notice with, I think, six essential elements that should be in all notices, and then if you want to see the longer notice form, it's somewhere else, you have access to it. But it is a way of simplifying.

MR. SCHRADER: All right.

MR. MARQUIS: But can I just, while I'm speaking --

MS. BROADMAN: I will yield the floor to Oscar.

MR. MARQUIS: As to Ron's point about market research, as to what kinds of notices would be more effective or be read more -- would be better read or get a higher response rate, there has been a ton of market research on marketing offers, and the response rate is 1 percent. I just can't imagine that you can do additional research that will show you get a response rate that's higher. People do not opt. They get too much mail, which, by the way, supports the Post Office and keeps those rates down to 37 cents. But if you offer something free, people don't respond.

MR. SCHRADER: Dorothy.

MS. BROADMAN: Well, Oscar just said what I was going to say, which is the same thing, that we won't get responses even if we simplify the language, and I think that there are examples of institutions that started with the complicated language, pulling the language directly to protect themselves legally, who have since converted to a more simplified notice and have not seen a change in the rate of response.

To Larry's question about when do we think we've been successful, I agree, it's not about response rate. I think we feel successful when we see that the notices are simple enough and that people who do want to opt out are getting the notice in a form that will enable them to do that. So I think that, to me, that reads as success.

To the Governor's question, there are examples, I think, of very good opt-out notices already that could be used and probably would work with slight modification.

MR. SCHRADER: Thanks.

Earl?

MR. JAROLIMEK: I just want to speak to a point I think that has been a little bit overlooked here. There has been a lot of discussion about the opt-in, opt-out, which one is better, the rate of return. I spoke with an attorney who works for a vendor company who produced a lot of the notices that went out from banks all across the country, and I can't give you the number,

but they are a very large company and I have to believe they did many of them. He reported that 85 percent of the notices he worked on and produced had no opt-out language in them at all. Because the financial institution he was working with had no practices that shared information outside the family, per the law, they weren't required to provide any opt-out option to their customers. So that leaves 15 percent of the notices he produced representing banks that either A) shared information outside the family or B) did what we did in response to the media attention that Teresa alluded to a year ago. We voluntarily gave our customers the ability to opt out of cross-selling information amongst our affiliates, and I know a lot of institutions I talked to did the same. Unfortunately, I think that action has been misinterpreted as meaning that we were required to give the ability to opt out.

So, you know, Ron, you alluded to some research, you know, it might be interesting just to know how many institutions really do share outside their families because I think in some -- respectfully, it may be a little bit of a solution in search of a problem given the fact that there is a lot of voluntary opt-outs being done out there.

We, for one, are considering, not only because we're headquartered in North Dakota and are trying to figure out what to do with our notice now, but we're looking at it very closely, and one of the things we're considering is joining that group of 85 percent and saying, if we're not sharing outside the family, why are we confusing the customers in any way, shape or form? Let's leave that language part out. And I just wanted to point that out. I think there is a lot of assumption that there is this sharing outside the family to a high degree, and I think it's, in my opinion, a very, very low percentage.

MR. SCHRADER: Frank.

MR. TORRES: Just to address -- I wanted to address a couple of points that were raised. First, we absolutely agree that a Schumer Box, or I've heard it called up on the Hill kind of a food label type of notice would be something that would be very useful for consumers, and we would certainly be interested in that type of effort.

I've heard several times today and yesterday comparing the response rate for the privacy notices to marketing offers, and I just wanted to remind people that we're talking about two fundamentally different things here, and so I'm not sure if the comparison is necessarily reliable.

You know, getting marketed for a product to me would be fundamentally different from choosing or deciding whether or not you want a financial institution to share your

personal information, and we're not just talking about names and addresses, we're talking about some things that the polls that I've seen show consumers are most concerned about. I mean, it's financial and medical information. So it's somewhat different for financial institutions that hold that.

We're not in this debate because -- we shouldn't operate in a vacuum. There are some serious concerns as the law was being debated about invasions of privacy in places like California and Minnesota that drove the debate. So we have to keep that in mind.

I completely agree with Ron's comments about perhaps conducting a survey, you know, and rolling that into the financial -- I could see that very easily rolled into any type of survey or focus group work done surrounding financial literacy and perhaps building that into the program as well.

One final point. We've also heard several times today about, well, you know, it was out there in the media, all this debate was out there in the media. I don't know if anybody necessarily wants to -- while the media does a tremendous job in most cases, I don't know if we want to kind of leave it to the media as the means of informing consumers and drop off everything else. I mean, we could say that there's enough information about all the accounting scandals, we don't need to do anything about that, and I think most people would disagree with that type of approach. So, you know, I think the media stuff is good, but we shouldn't say we don't need to do anything else because it has been discussed in the media.

MR. SCHRADER: Oscar.

MR. MARQUIS: First of all, just one point you made, we're not talking about medical information, we're just talking about financial information.

I think an issue that -- a fundamental issue is do consumers consider it an invasion of privacy if their name is on a mailing list. We're not talking about anyone knowing anything about their income or their personal information; it's name and address on a mailing list. Is that really more serious than a marketing offer, an offer of some benefit or service or better terms on a credit card or whatever?

As to opt-out, opt-out has been a part of the Fair Credit Reporting Act since 1997 where consumers, every time they get one of these credit card offers, have an opportunity to opt out of the credit bureau list. The response rate there has been similarly low.

The response rate is high where consumers care to opt out, and that's opting out

of telemarketing offers. People do not like telemarketing offers. Even though they seem to work, and that's why the industry exists, people don't like telemarketing offers, and opting out of telemarketing calls is higher than opting out of getting pieces of mail or being on a mailing list.

MR. SCHRADER: Okay. Agnes.

MS. BUNDY SCANLAN: Just a quick point on the focus groups that Ron had mentioned. Many institutions already conduct focus groups. Certainly they conducted them in preparation for the initial notice, and many are conducting them now as they prepare for the 2003. We've just finished with a series of focus groups in preparation for 2003. So I do think many institutions are conducting them, and if they didn't, they are starting. Certainly at the December 4th workshop, we heard a lot about the relevance and importance of conducting focus groups. So I do think that institutions are doing that type of research as they prepare their privacy policies.

MR. SCHRADER: Elizabeth.

MS. RENUART: One point on whether it's a success or not in the response rate, from the financial institution's perspective, you might say, well, we spend all this money, and so we want a response rate. But on the other hand, you really don't want a response because a response means that now you can't share the information. So a low response rate is really what you are after here, and that succeeded this time because now you can share the information.

The issue is you really want people to read the notices, and so I think that's why this debate has been very helpful, to figure out how the notices can be best suited for consumers to actually read them. But I don't think the response rate is what you measure in terms of success, at least from the financial institutions' perspective.

MR. SCHRADER: Teresa.

MS. BRYCE: I don't think that's a fair assessment because I think you can't underestimate what Earl is saying. There are a lot of us as financial institutions that decided from a competitive point of view that we were not going to share information. You know, here we were going to have to have a privacy policy, it was going to be on our Internet site, and we just felt that it was important to tell customers, we're not going to share your information outside of our company.

There were certainly a number of us in the room who had made that decision for our companies based on the information that Earl was just talking about. In some respects, we may be talking about a fairly small percentage of the industry that's even sharing the information in order to have an opt-out, and I wonder if we are sort of escalating this issue, because if many of us have

already sort of made the decision -- I think there was an assumption by many that we would never do that. Nobody even anticipated that as institutions, we would make that decision to say we're not going to share the information, so there is no need to opt out because we're not going to do it, and I think there has to be some evaluation saying, how many institutions is that?

I'm not suggesting that there isn't some room to improve the template and to make it, you know, simpler with a card or something to send it out, but a lot of companies are doing that already and have, you know, tried not to be un-customer friendly, you know, in fact have tried to be customer friendly, and still the response rates are low.

MR. SCHRADER: Larry.

MR. HAWKINS: There are just too many other things that you have to fix to make this thing successful even from your perspective.

Let's not talk about what I want for success; let's talk about what you want for success. I still don't believe you are going to get it any more than you are going to be able to get the voter turnout to be a lot larger than it is. There are just too many other things that have got to be fixed. Please, simplify the notice. Make it real, real simple. You know what? Your response rate is still going to be low. It's as simple as that.

MR. SCHRADER: Frank.

MR. TORRES: I'm just curious, amongst the financial institutions here, is there any company that you are not sharing information with today that you were sharing information with before because you've decided not to share information outside not just your affiliated companies, but companies with which you've got servicing contracts and other things as well? I'm just curious.

MS. BUNDY SCANLAN: Yes.

MR. TORRES: I mean, who are the outside third parties that you wouldn't have ordinarily shared it with?

MS. BUNDY SCANLAN: Yes.

MR. HAWKINS: No.

MS. BRYCE: We already had a policy of not sharing information for marketing purposes, so the only information we share is with vendors who we have to give information with in order to do an appraisal or, you know, those types of -- in order to deliver the service.

MR. JAROLIMEK: Our voluntary opt-out was focused on customer sensitivity

and the cross-selling of, you know, privates amongst affiliates. We actually gave a voluntary opt-out to 450,000 customers in 1998 in response to the attention being given to privacy suggesting that they would not be on any type of mailing list whatsoever, even from the bank to the customer, which is a, you know, pretty direct relationship, in response to their sensitivity to mailing and calls and such.

MR. SCHRADER: Tom.

MR. FITZGIBBON: I just want to echo my colleague from the credit union industry, is that, you know, our ownership and trust and relationship with our customer was so precious that we never shared nor would we ever share that private information with a third party for any reason whatsoever, especially because of the potential reputational risk that comes with that, and I think you will find that that was a pervasive philosophy in the banking industry because of the -- it's tough enough to get a customer, much less to lose them to some third party through some relationship where we would share information.

MR. SCHRADER: Now, I realize we've run a little bit over. Is it appropriate, Dorothy, at this time for me to maybe make a wrap-up summary of what we've gone through in the last 55 minutes?

MS. BROADMAN: I think you can take more time.

MR. SCHRADER: We have --

MS. BROADMAN: More comments.

MR. SCHRADER: Any other comments?

MR. TORRES: I really don't have -- I'll get myself into hot water here, but, you know, the conversation today and yesterday has been very interesting for me. One of the original reasons why we got involved in the privacy debate, especially with regards to the financial and medical information -- I know we're not taking medical information here, but I combine the two because it seems those are the two areas that have been identified that consumers believe are very sensitive information. To share account information, to use that information to make decisions that may affect a consumer's ability to purchase a product not from a credit-scoring or underwriting perspective, but almost from a red-lining perspective, we thought was kind of fraught with dangers and difficulties and thought that consumers should have some control and knowledge and be able to make wise choices.

Putting all that aside, I mean, what I'm hearing today is, you know, there's a big

concern about the use of information to market to consumers, which might be put in a little different realm. I mean, certainly you could, you know, pitch the offers that you get in the mail if you want and that type of thing.

Now, having said all that, we do think the notice that comes out to consumers is important to inform them of what choices they do have under the law, and so therefore I do hope that the Fed moves forward with trying to figure out how to simplify the notices that do come out.

MR. SCHRADER: Agnes.

MS. BUNDY SCANLAN: Just one quick comment in support of Ken's comment regarding federal preemption. We haven't talked a lot about that today, we didn't spend a lot of time talking about it yesterday, but that is certainly something foremost in many financial institutions' mind because of the fact that there are 50 states, and having one federal law and then complying with different 50 -- 50 states' types law, particularly for an institution as large as ours, we have business in all different states, so that is something else that the Fed could consider to assist financial institutions and others with as you continue with your thoughts on privacy.

GOVERNOR GRAMLICH: That is written in law, as you know, so there's not much we can do with that.

MS. BUNDY SCANLAN: I know that.

MR. BORDELON: Just a final comment, Russ, that I think that it has been mentioned I'm sure in the comments to the Board that the issues of privacy and security sometimes get muddled and mixed together, and to consider that financial institutions are looking at not only privacy issues, we are looking at security issues with ID theft being one of the, you know, the hot items right now, plus the USA Patriot Act. So all three of these basically bump against each other, so I would ask you to consider that, in the analysis of the privacy issues, that the others also are considered.

But it's amazing sometimes what -- I think we're underestimating the sensitivity of our consumers. They know what privacy is. I know, for example, some financial institutions in our area implemented a project called Thumbprint for checks being deposited in their institutions as a security and fraud prevention technique and got a severe backlash because of invasion of privacy. So these issues can frequently get really muddled.

MR. SCHRADER: Please.

MR. ABBATE: You know, I would just like to add a postscript here, that we're

all so concerned and fixated on this privacy notice that we seem to gloss over the Bank Secrecy Act and the Patriot Act that requires enhanced due diligence on account opening and knowing everything possible about your customer and what his business is, what his background is. I think that really goes far beyond what this privacy notice talks about. So all this major concern about opting in and opting out, I think at some point that people have abrogated their right to privacy by federal legislation that enables us to find out everything there possibly is about our customer so that we would know about his habits, his activities, what kind of money he deposits, where he works, what he does.

So I think there is just a fixation on privacy, and we ought to be looking at what we've taken away from the public with the Privacy Act. I acknowledge that it goes to striking at the heart of terrorism, but there has to be a balance. So let's not get too crazy about privacy.

MR. SCHRADER: Mindful of the time, let me see if I can summarize some of the points that we've made, both yesterday and today.

I think we all agree that this is definitely a process, and that the first round where the notices were closely hewing to the model language perhaps were not models of clarity and understanding, and that certain issues are working with focus groups and so on in order to simplify them.

There is a strong interest in working to simplify things, perhaps in terms of a template that would meet both the legal requirements of the Gramm-Leach-Bliley and Regulation P, but at the same time would be perceived as more consumer friendly.

The experience that people have had is that a small number of people are opting out. Whether it's 13 of 56,000 or 1 percent or 5 percent, it's a small number. The meaning of that number and the significance of it is unclear.

In the case of marketing materials, a 1 percent response rate is considered extremely good, so a 5 percent response rate would be excellent, but it is not clear as to whether people are not responding because they don't care or because they don't understand.

We talked about the timing of the notices, that people tend to read privacy notices when they are interested in privacy; Larry's point, that you look at a car ad when you're interested in buying a car; you don't notice car ads when you're not interested in buying a car.

Teresa made a point that we need to be careful that corporate affiliation and how companies have chosen to organize themselves not be seen as driving this particular notice, and that

you look at how the relationship is with the entire institution.

The point was brought up by Anthony and by Ken that there are -- and by Oscar as well -- that there are actually four separate concepts going on at the same time and that without a certain intellectual rigor, they tend to become muddled. Those four concepts are privacy, security, identity theft, and telemarketing, and that people don't like telemarketing calls, as Oscar pointed out, but it seems to work or people wouldn't do it.

Security and the U.S. Patriot Act and the war against terrorism is paramount in everyone's mind, and that there may be certain tensions between security and privacy in the time ahead.

A point made by Ken and echoed by Earl in North Dakota, and Agnes, is the tension between Regulation P and Gramm-Leach-Bliley and state laws, whether the burdens imposed on small institutions in particular in dealing with layered, possibly inconsistent state laws is something that perhaps may be necessary to look at, as Governor Gramlich pointed out, at the other end of Constitution Avenue, but the point remains that there is the possibility of state laws that would add a burden to the operation of small banks in particular, and that consistent harmonious, you know, regulations and laws would be considered more desirable by some, opposed by others.

Thank you very much, Dorothy, for extending the time and for our rigorous discussion. I think you got a flavor for what our meeting was like yesterday.

MS. BROADMAN: Thank you, Russ.

Now we will turn our discussion to the Community Reinvestment Act and this will be led by Manny Casanova.

COMMUNITY REINVESTMENT ACT

MR. CASANOVA: Good morning, everyone.

As you know and as we mentioned at our last Council Meeting, there were numerous comments that were received from industry and from community groups regarding the 2001 advanced notice of proposed rulemaking as it pertains to Regulation BB, which, of course, implements the Community Reinvestment Act.

Our Committee discussed last March the merits of the investment test and the definition of small banks. This time, in our Committee meeting yesterday, we focused on three main areas. The first area was the evaluation criteria of a bank's community development activities;

number 2 was the performance context; and number 3 was examiner training.

I would say that we spent about 75 percent of our time focusing on the first point, which is evaluation criteria of the banks' community development activities, and to that point, regarding the evaluation of a bank's community development activities, there was consensus, I would say, among the Committee members that there are certain terms that probably need to be reworked or revisited, specifically the terms used "innovative," "flexible," "complex." When an examiner is going through that whole analysis and when a banker is looking through those terms, you know, what does that really mean? So we will hear from the Committee members on that.

It gets to the point, as we went through our discussion, that those terms are so broad that in some sense now, you know, those terms could be undermining maybe the real intent or the real purpose of CRA, and we will discuss that in a minute.

Let's see. One example that was given was if a bank, for example, consistently every year makes a million-dollar loan to, say, a community development corporation and there is a certain template that is used, it has been tried, it has been tested, everybody is happy with it, no, it's not innovative, you know, no, it's not creative, it's not very complex; however, that million dollars a year, say for that particular institution and for that community development corporation serves, obviously, a need in that particular community. So obviously, you know, the bank wants to receive some points, community development corporations are happy, but no, it's not innovative and it's not complex.

The question that was put forth by the Fed staff is this: You know, has the agency correctly identified the relevant criteria for judging an institution's community development performance? If not, what are the relevant criterias?

With that, what I'm going to do is turn it over to Buzz and we're going to talk about some qualitative and quantitative issues.

MR. ROBERTS: Well, thank you, Manny.

I think one of the things we discussed was that to really look at the qualitative contributions a bank is making through CRA, you have to understand the community context in which those needs are expressed and prioritized, and so even though it may not be part of the structure of the CRA exam, I think several people suggested that more attention be given to the community context of a given institution.

Second is that the community development aspects of the CRA exam are the

areas where the qualitative factors come into play most often, and that the current exam structure makes the evaluation of community development activities more difficult than is necessary by fragmenting those activities among the three tests -- lending, investment and services -- rather than pulling them together into a single coherent community development test. So, for example, filling the boxes in a given part of the CRA exam can become more important to examiners and, hence, to institutions than addressing the actual needs of a given community.

In some cases, the difference between a CD loan and a CD investment is more formal than substantive and needs to be treated more substantively than formally. In other cases, it is very difficult for the lending activity to really -- I'm not sure this is picking up. It's hard for the community development lending activities to get full consideration within a lending test that is inherently more quantitative and in which the volume of community development loans is going to be dwarfed by a large number and large volume of broader lending activity.

Also, geographic constraints within the CRA exam make it hard to get community development credit into the communities that need it, and so opening up geographic constraints within a community development test would be helpful.

In terms of the qualitative factors that Manny referenced earlier, innovativeness and complexity may in fact have been the right criteria in the early to mid '90s when the last rule was drafted. Since then, we've seen a lot of innovativeness and maybe too much complexity, and maybe rather than as goals in and of themselves, they ought to be seen more rightly as means to the extent necessary to address communities' needs. As Manny said, what was innovative five years ago may be no less valuable to a community today because it is -- the innovation is complete, and complexity doesn't necessarily equate to responsiveness to a community's needs. We've seen inordinately complex transactions that really add no value to communities that we can discern.

So rather than put what a bank goes through at the center of CRA, it might be -- we might be better served by putting communities first, and so for example, to look at how important an activity is to meeting a community's needs would be one thing to consider, a second is, what kind of level of leadership does a bank exhibit in addressing its community's needs, a third might be to look at whether a bank is serving even the toughest communities within its assessment areas, and a fourth might be does a bank's overall community development activity contribute to the community's long-term sustainability rather than maybe innovativeness and complexity may be appropriate in getting to those factors, or maybe not, but they would at least be seen in a broader

context.

MR. CASANOVA: Thank you, Buzz, for those comments.

I will share with the Committee that one of the things we did yesterday was I went ahead and brought my bank's performance evaluation which, of course, is public information, and I drew from some of that evaluation some of the comments that were made by the examiner. It was a very thorough, very complete evaluation. Frankly, we had no disagreements. There were a lot of tables that were used, done by the FDIC, a lot of tables are used throughout this evaluation, a lot of data. There's a lot of, of course, aggregate data that's used, you know, that frankly compares our performance to the other banks in the area. A lot of areas we did very well in; others, we did not.

So when you look at the raw data, you know, and we started talking about self-assessment -- I think, Governor Bies, you had maybe some interest in that -- we were talking about self-assessment, and certainly the tables that are used in this evaluation are tables that we can certainly use going forward.

This examination was done in '99, so we've done self-assessment, you know, for the years 2000, 2001, so that when the examiners come in, and we're expecting them in August, I'm sure they are going to do the same thing, and so we can maybe discuss, you know, the data.

I think, Thomas, you had some comments about that self-assessment process.

MR. FITZGIBBON: Right. I think one of the things that I think is important is, as the regulators have helped the industry, frankly, develop these comparable tables that now are standards, so that we now have real things that we can compare ourselves to, the industry to a certain degree has not developed the skill set to be able to adequately use those comparable charts and pieces of information so that they can perform their own self-assessments in what I would call a professional manner, because we get the calls. Those of us who have sort of done this for our own institutions, we get calls from our peers who say, can you help us think through this?

So one of the things I think we talked about yesterday was that there really is a need to develop that skill set within the banking industry itself so that the self-assessments can be done more adequately and provide those institutions who are large banks but aren't really big financial institutions so that they can perform their own self-assessments in a more professional manner, and that's a problem.

So looking at the Institute for Financial Education, the AIB and other banking

advocates to be able to help provide that sort of training in such simple things, perhaps, as being able to learn how to be CRA Wiz, which, one would think, is relatively simple for those of us who use it, but for a lot of institutions, that's a real leap of faith. You know, moving from Word '97 to CRA Wiz is a big leap for some.

MR. CASANOVA: Thomas, I didn't ask you this yesterday. Would you think that the banks maybe above a certain size, like say 500 million, their self-assessments are better than maybe banks below 500 million?

MR. FITZGIBBON: It tends to be in the institutions that are relatively small, a billion and half and smaller, where the expertise is not necessarily at a level that it needs to be in order for them to perform adequate self-assessments, and in a lot of cases, the folks who are left to try to perform that are the folks or the compliance officers who also double as the Privacy Act officer and the security officer who now also have to perform the self-assessment using CRA Wiz.

So there is a lack of talent, I think, or at least the talent there, it needs some more help so that it can perform those things and give management better information to make a judgment on the performance.

MR. CASANOVA: Okay. Thank you very much, Thomas.

There were some questions or we had some discussion about not only putting monies into non-profits maybe one year, two years; there was a concept -- I think Janie brought that up -- as far as sustainability. Do you want to share some of those thoughts, Janie?

MS. BARRERA: Yes. Thanks, Manny.

You actually spoke about that already in your general report, but specifically, when we're talking about innovative kinds of issues regarding the CRA, well, you know, why does everything have to be innovative every year? You know, you do something, you invest in something one year, and then the next year you've got to think of another project, totally different, and what happens then to the sustainability of the nonprofit or of the community development organization? So by looking at that as well and to long-term commitments, you know, five, ten years, what is the sustainability of that CDC or that nonprofit organization as a way to meet the investment criteria.

Then the other point I would make, too, is that, you know, banks have put in a lot of effort and a lot of time and money into developing their CRA departments, and this is something that just didn't happen overnight, and so I think it's an ongoing fluid kind of operation, and it's

something that needs to be done, and an example would be, too, that, as part of that, to find out what the community needs are.

As Tom talks about, you know, doing the assessment from the bank's perspective, I think that's something that the Fed could also do from the Fed's perspective, is find out what are those community needs by bringing people together, by, you know, some kind of a means to do that, and see how well do they mesh, you know, the banks and the community's ideas together.

MR. CASANOVA: Okay. Thank you very much, Janie.

Anthony, did you have a comment?

MR. ABBATE: Yes. I may be going far afield, but Thomas brought up a relevant point, and that point was the fact that folks that are responsible for CRA sometimes act in a dual or even triple capacity handling other items. He also pointed out the fact that that's prevalent in smaller banks, a billion dollars or less.

Well, I hate to dredge this up again, but I think that it points out to the fact that it's difficult to try to find qualified executives to be responsible for CRA in smaller banks. As a matter of fact, in my institution, we have out-sourced compliance in CRA because we can't find qualified people, okay?

So I know I suggest that when we look at this revised -- or proposal to revise CRA, that consideration again be given, and I know that it's not a very popular thing, to subject banks, say, under a billion dollars in assets to the small bank CRA exam because we just don't have the staff that is able to comply with the statute, and that goes to the heart of what Tom FitzGibbon was saying.

MR. CASANOVA: Thomas.

MR. FITZGIBBON: I want to draw the distinction here, Anthony. There's a difference between CRA compliance and community development. CRA compliance is complex, it's not innovative, but it's complex, and so it requires a certain skill set that to a certain degree is hard to find within the industry.

Community development, on the other hand, is part of lending, if you will, or investment, or other things that a bank typically can do if it desires to do that.

So the difficulty here is not necessarily being an active institution and providing investment and loans and leadership, but it's accounting for it on the back end. So it's a little bit of a

different skill set.

Thank you.

MR. CASANOVA: Before we get to Earl, Governor Bies, as far as the self-assessment, was there anything else that we could add, any questions that you may have had about that discussion?

GOVERNOR BIES: Well, I guess the issue that I have raised is, if we look around at best practices for whatever control you're looking at, you know, whether it's the foundations of control at organizations or compliance, or just the way we self-assess marketing programs, credit-decision programs, underwriting, self-assessment in the '90s became a proven tool for best practice. And my question really is, are we doing enough to encourage organizations who want to get the best practice and find out what really is effective to use more self-assessment techniques, and are we as a Board putting any roadblocks in the way for that to happen, or what could we do to facilitate it?

MR. CASANOVA: So if our particular bank has one self-assessment approach and Thomas' bank has another self-assessment approach, his practice actually may be better than my practice, and so how do we get together to talk about that.

I think you are next. I'm sorry. Go ahead.

MR. JAROLIMEK: Thanks, Manny.

I would just suggest that, based on our experience with the Community Reinvestment Act, several examinations since 1995, community development used to mean the entire community, and I think we've fallen away from that to a high degree. The test now for community development seems to me to be rather narrow, and there has been some unintended consequences, I believe, of that where banks have been forced to make decisions that they wouldn't otherwise make had it not been for the low or moderate income test.

Unfortunately, it has been to the -- I don't want to use the word demise, but there have been negative effects to the community. Several bankers from our branches have called me with examples of things that they have done in the past; they might be loans, they might be investments, they might be services they've offered to schools, hospitals, YMCAs, Girl Scouts, United Way. Many times, I've had to say that's a really good thing you're doing, but for CRA purposes, we're just not going to be able to count it, and many times they'll say, well, get, okay, we're not going to do that anymore, and I say, wait a minute, you have to do it, it's good for your

community, you know, don't let the CRA test govern your activities within your own community.

They've only got so many resources, and I would just suggest that if the performance context could again take into account some of those activities, it is going to be for the betterment of the communities.

MR. CASANOVA: And we will move over to the performance context in a minute.

Dorothy.

MS. BROADMAN: Well, a couple of comments. One is to respond to the Governor.

It's an interesting question, is there something that could be done to encourage self-assessment? If you look at the fair lending exam process, there is in that if we do a self-assessment and it's found acceptable by our regulatory agency, we may go under a streamlined exam rather than a full exam. So there is a clear incentive to do that kind of work.

I don't know how many institutions are doing that. I know the one I worked for before did engage in that practice with the hope of getting the streamlined exam. I think you could look at something like that for CRA. I'm not sure that it would work, but maybe it would, and it's probably something worth exploring in that sense.

I think when we get into the discussion of the performance context, you will hear that what is going on now is probably discouraging that kind of self-assessment, so I think we will leave that for that discussion.

In terms of community development, I wanted to touch on that as well and support Earl's comment that we would like to see a broadening of the definition of community development.

I think one thing that people who work in CRA compliance struggle with is just that, the negative effect that it has on activities and also enthusiasm of staff inside the banks, because if there is something they want to do and they are told it won't count for CRA, that has a discouraging impact, and that's especially true in the service test area.

I think it's important to note that CRA has evolved tremendously since this rule was written, and it is important for us to take stock of where we are and where we want to go. We've made tremendous strides in this area, and I think we're probably in a fairly mature stage within CRA.

In my mind, what's important is to encourage activity and not get so caught up in precise narrow definitions, so that something doesn't get credit that isn't clearly going to serve low and moderate income people.

I would like to see a broadening so that we would just encourage more activity and more things would count under CRA, and particularly in the community development area, I think it's important to bring in home mortgage financing, because now, if an institution does an important, impactful program that involves homebuyer counseling, provides bringing in subsidy funds, maybe through the Federal Home Loan Bank HP program or through a partnership with a nonprofit that is able to deliver the subsidy funds, those activities go into the HMDA data, and if you do ten very time-consuming but impactful loans, you've got ten HMDA loans, and there is no community development credit for that.

So I think in some communities, that activity is very important and maybe more important than multi-family lending, which does get community development credit even though it also may be in the HMDA reporting, and there may be some examples of small business lending that are highly impactful and time-consuming, and we want to encourage institutions to get into that, and one way of doing that would be giving community development credit for certain activities.

MR. CASANOVA: As a banker, I couldn't agree with you more.

Hubert.

MR. VAN TOL: To Earl's point, I think one of the -- I think in urban areas, we have to be very careful about counting anything and everything as community development, but I think there is a case to be made in rural areas where the Census tracked data is much less differentiated and it's much more difficult in small-town America to make the -- or to not make the case community development efforts -- it's harder to focus community development efforts on low and moderate income communities without affecting the whole community or the community development effort that affects the whole community also has a strong impact on low and moderate income communities.

But I think in the larger urban areas, we would have to be very careful about going down that road of broadening the definition too much because, you know, many of those United Way type activities I think are, you know, very fine activities, but they aren't -- they don't meet the needs or they don't fulfill the original purpose of the Community Reinvestment Act.

MR. CASANOVA: Hubert, would you agree as far as the terms "innovative, complex," that those need to be revisited, or you're thinking those are acceptable?

MR. VAN TOL: No, I think I agree with what has been said before, that in terms of, you know, trying to get at how we can improve community development efforts in communities, maybe it is putting all of that into one test, into a community development test that polls -- you know, that is based on the investment test. Maybe that does make some sense.

The worry I have about that is that then we begin to view the investment test simply as a vehicle for relating to nonprofit organizations, and we're not also stressing that the investment has to go into the small private entrepreneurs and low and moderate income tracts as well, that we don't lose sight of that.

MR. CASANOVA: Thank you very much.

Thomas?

MR. FITZGIBBON: I just want to follow-up on Hubert's comment because it does follow in the investment test. The difficulty when you are dealing both in rural and urban markets, when you are trying to -- when municipalities are trying to raise capital to do infrastructure, water systems and water treatment plants and sewer plants and things of that nature that are really vitally important to the economic viability of both urban and rural markets, is that unless you can prove to a degree of certainty that 51 percent of the people who use that water system are low or moderate income, it does not count.

I think to a certain degree that has been a negative when it comes to small-town participants, branches who say, we'd like to buy this municipal bond because it's important and we want to hold it, but it doesn't count, it has no value from CRA perspective.

So I think we -- you know, broadening the concept, but I think, you know, again, dealing with relatively limited types rather than general obligation bonds, really looking at specific types of financings that help educational facilities, infrastructure and economic development, job creation, I think would be really helpful and probably encourage more investment and lower the costs of those financings of the future.

MR. CASANOVA: The comment I made yesterday along those points, there was a Federal Reserve Board report out of Dallas that talked about our particular area down in Texas, the Mexican border, that the number one priority for that region was education.

So the UT system, they're looking for about $80 million in general obligation

bonds to be funded, and our guess is that all five or six banks in that area will be purchasing those particular bonds. Will those banks get credit for CRA? You know, that's the question, and we are not sure about that. But it would lead to community development, you know, education. There are so many positive effects that come out of that that we're not really sure if CRA really addresses that.

So let's go to, I guess, Ruhi. You have some comments.

MS. MAKER: I wanted to follow-up on Dorothy's point. I think we have gotten to the point where people can have access to credit. What they don't have is, whether they are a micro-business or a homeowner who needs the counseling, is that technical assistance that accompanies whether, you know, the extension of credit to the micro-business or to the homeowner, and I think that is something that is absolutely critical, and whether we do it by creating a community development test that then gives, you know, credit for CRA for that kind of innovative work, whether it's working on lending issues, all of these issues, banks are starting to do that. I mean, in a sense, it's customer development. Certainly I would find it would be very frustrating if I, as a community group, I was told, well, you know, we're doing all this home mortgage counseling, but all I'm getting credit for is HMDA credit.

I think Tommy touched on the bank being able to sell what they are doing to the examiners and to the regulators as being critical, and it does then bring us also to the performance context, you know, understanding what is needed in that community, and if the community groups are saying, hey, that works, and if the bank is saying, hey, that works and we need it, and yet it doesn't fit into the box, then we sort of created a monster that we need to, you know, figure out a way of getting out of, and I'm not sure that we're quite there and we need to come up with regulatory language that will satisfy us all, be flexible so then everyone doesn't scream and say, hey, nobody gets anything done.

So I think I recognize that the task is challenging, but I think it's doable, and I think the communication that Janie talked about where -- when -- if both the bank and the community groups are saying this is good, and still you can't get CRA credit for it, then something is definitely wrong there. I would agree with that.

MR. CASANOVA: Patricia.

MS. McCOY: Yes. Thank you, Manny.

I'm fascinated to see this theme that broad-based counseling or outreach or educational efforts on the parts of banks are not receiving CRA credit, because obviously many

times those will reach target groups, even if those target groups are not a majority of those reached.

We tussled with this in a separate Committee meeting yesterday on the topic of financial literacy where a number of banks reported that if they partner with local schools to go into the schools and do classes on some aspect of financial literacy, they would not receive CRA credit unless they could prove to the examiner's satisfaction that a majority of the children in that classroom were low or moderate income. That's just too tough of a test, and it counteracts the Board's efforts at financial literacy, so I think we could use liberalization in educational efforts.

MR. CASANOVA: Thank you.

Buzz, yes.

MR. ROBERTS: A couple of people have mentioned area-wide activities as being community development benefit, and I would like to suggest that where the area as a whole is particularly poor or distressed, then that would make, I think, a lot of sense. Indeed, if you're looking at an area -- Census tract that has to be below 80 percent of some median, but that median, that denominator is itself so low that it's hard to get much below that very low denominator, that does make the test unreasonably hard.

So you might want to consider other factors as well. You know, in South Texas, I suspect poverty rates are high, unemployment rates are high. In parts of the upper Midwest, I suspect out-migration rates are quite high, and these are quantitative criteria that could allow you to discern those distressed areas where some kind of loosening up might make some sense.

I do think you have to be somewhat careful, though, to avoid a situation where you have a middle-income or even upper-income community where area-wide benefit activities are getting CRA credit because if CRA includes everything, then it really includes nothing.

MR. CASANOVA: Right.

MR. ROBERTS: And we don't want to fall into that trap.

MR. CASANOVA: You're right.

Thomas.

MR. FITZGIBBON: I want to follow-up on Dorothy's comments about, you know, what counts, when you mentioned the difficulty to do HMDA loans and all it counts for is HMDA. We have this other, which is called the Other Loan Category, which in the examination is typically other things that the bank has the option of providing to the examiner for consideration, and the problem given to the weight, if you will, or the value that's given to this Other Loan

category, it's sort of, oh, okay, well, in addition, you know, they reported consumer loans and it penetrated this market.

One of the difficulties, and it may be only pervasive in urban markets or at least in the older urban markets in the Midwest, is the problem related to what we refer to in Chicago as a two-by-four or one-by-two where you have two retail stores on the first floor and two to four units of residential above. We do about 300 to 400 of those loans per year because they're in our footprint. That's the type of thing that we do. It's not HMDA reportable because more than 25 percent of the space is for commercial purposes, and it's not small business loan reportable for CRA purposes because it's real estate oriented. So this is the type of transaction that tends to fall through the cracks.

In our last examination, we did provide all of that information to the examiner, but it was sort of like, okay, it was other loans, and so it wasn't given the kind of weight, I think. And perhaps there are other experiences in urban and rural and Indian country markets where similar kinds of experiences are there, but certainly I think giving something in terms of weight or value to this Other Loan Category at least of equitable proportion might be helpful.

MR. CASANOVA: Dorothy.

MS. BROADMAN: To follow-up on that, even before Tommy spoke, I was going to talk about this, and I just want to clarify that when we do counseling for a special homebuyer program, we do get credit for it under the service test; the issue is the weight of that credit is not sufficient enough to really create enough incentive.

When I talk about the evolution of CRA and that we've come a long way and it's important to take a look at where we are, what I'm talking about is that in some markets, a focus on making mortgage loans to low and moderate income customers is not what is needed. Some of these markets are very well served, the banks have stretched to levels that some people think are maybe not wise, but those markets are essentially very well served.

I don't know if this is making something that's already too complicated even more complicated, but I'm wondering if it would be possible to have a range of weightings, and so that an institution could say, we didn't emphasize mortgage lending to low and moderate income communities, but what we did emphasize was financial literacy because that's what's needed in our community.

Therefore we would like you to put more weight on those activities that we were

engaged in, because our communities are different and the level of services provided by the banking industry varies by markets, and that might be a way of encouraging us to really look at need in trying to find what's impactful.

I am very well aware that what we're talking about is in a sense going back in some sense to the old rule because perhaps some benefits there have been lost.

MR. CASANOVA: Okay. Very good.

Larry, did you have some comments?

MR. HAWKINS: Yes. I've just got to tell you, and I'm a banker, the thing that's a little spooky about that is that the initial intent of CRA was to address credit need and providing the financing. You put all this weight on this educational part and what have you, so somebody does wonderful on the exam because they did all the education but they did no loans, we've got a serious problem.

So how you balance that out and how you give equal weight in some of this other stuff kind of defeats the purpose of why CRA was put on the books in the first place, as I look at it. So, you know, I don't know what kind of balance it should be. I don't know if you get two for one if you actually loan the dollars and you get less if you do the education. All those components are very, very important, but you've got to be real careful or essentially we digress.

MR. CASANOVA: Governor Olson had a question.

GOVERNOR OLSON: I touched my microphone, too.

(Laughter.)

GOVERNOR OLSON: Another underlying presumption of CRA, at least in its historic context, is that it was bricks-and-mortar based and that it was designed to assess the neighborhood. My question of the group -- let me back up one more. At the time that the current rules were put in place, I think that there was some wisdom in asking for a window to review them out in a seven-year context.

It seems to me that the most -- one of the most significant developments in the meantime has been the advent of technology and the ability to lend and deposit-gather outside of the immediate neighborhood, and I'm wondering to what extent the implications of that for CRA were discussed by the group.

MR. CASANOVA: Thomas.

MR. FITZGIBBON: We didn't discuss it at length, but I think there has been

some concern -- yesterday we didn't discuss it, but there has been concern or talk about it in previous meetings, and the competition, the playing field has changed in that last seven years with Internet banking and other types of ownership of financial institutions with access to federal insurance has changed and the sort of lack of standards for that section of the industry, the insurance-owned banks and others, and credit unions, frankly, who aren't part of the CRA, which bothers me as a taxpayer.

(Laughter.)

MR. FITZGIBBON: With respect to Ken, my colleague.

So I think it's important to really look at, you know, the wholesale banks, limited purpose banks, and others who have come along, really, in the last seven years and perhaps that's something we can discuss in future meetings, because it has changed, the playing field has changed, the competition has changed, and our ability as a financial institution to respond to various credit needs has changed, both good and bad, and that has not -- we haven't really looked at that in the context of how the CRA rules are in place today.

MR. CASANOVA: Why don't we go to Janie and then Hubert.

MS. BARRERA: Well, I don't have a comment on the technology. I'll defer until we change subjects or change ideas.

MR. CASANOVA: Okay. Very good.

Teresa. I'm sorry.

MS. BRYCE: Just to that comment, I think a lot of financial institutions who have been expanding their horizons from a technology point of view, whether it's doing mortgages over the phone or over the Internet or other depository type services over the Internet, still sort of view the fundamental footprint of where there bank branches are as being sort of the area that they have to look at for CRA purposes.

But I think your question is spot-on because there are Internet banks now, and, you know, I've wondered sort of how do you approach CRA as an Internet bank where you really don't have any bricks and mortar and you're looking -- how do you go about assessing where you should be putting your investments, because you may have -- you know, do you look at where the preponderance of your investments are coming from? I think it would be very difficult to try to be something to everyone in every market where your investments are coming from.

I don't know what the answer is, but I do think we've seen much more of an

evolution, particularly over the last two years, of that type of institution, and how it's being addressed, I just don't have any idea.

MR. CASANOVA: Patricia, did you have a comment on that?

MS. McCOY: Yes. In response to the Governor, the question of whether or not the geographical test makes sense I think we can divide into two different components.

With respect to lending and community development and investment, I would agree that investment in low-mod communities that might be outside of assessment areas should receive credit, and I've heard way too many stories of such investments that are not made due to concerns that they fall outside of assessment areas.

On the other hand, in the deposit-taking area, I think in this room we're all painfully aware that the geographies that we seek to serve through CRA in encouraging deposit-taking and basic banking services within low-mod communities becomes harder and harder with each passing year, and to some extent our default position now may be becoming partnerships with check-cashing outlets, which is highly problematic.

GOVERNOR OLSON: I didn't catch -- what is harder and harder to discern each year?

MS. McCOY: Every year, it's harder and harder to provide basic deposit-taking services within low-mod communities simply because of the exit of banks and thrifts from those communities, and our default position seems to be how do we deliver those through check-cashing outlets, which I view as highly problematic.

MR. CASANOVA: Why don't we take about two more questions on community development activities. Hubert, go ahead.

MR. VAN TOL: I wanted to go directly to the Governor's comment. I think the key to solving that problem is de-tying the assessment area to deposit-taking institutions, that we have to tie the assessment area to the broader area of an institution's lending activities and financial service activities in general.

In rural America, we're seeing more and more. In the upper Midwest, it probably isn't as much of a problem yet because we have a strong community banking network, but in other parts of rural America, for instance, a City Financial becomes a huge marketing tool. For instance, in my town, I get a postcard, you know, a placard, a brochure for a loan every month from them. But Citicorp itself would not -- its assessment area would just be a number of metropolitan areas.

So our rural areas, particularly less served rural areas, are really getting into problems because the assessment area is tied to deposit-taking parts of the financial institution. I think we have to deal with that.

If we're going to change the CRA regulation, I think we have to deal with the assessment area issue. Otherwise, I think it's better to leave it alone, because, to me, that's the key of some of the problem we have with the investment test. To allow banks to have a broader assessment area that includes more of where they're doing business would alleviate some of the problems that people are complaining of, a scarcity of places to put investments, and, you know, it seems to me that that's one of the keys.

MR. CASANOVA: Buzz.

MR. ROBERTS: Yes. I just want to build on comments that have already been made.

A major reason why many institutions are going to non-bricks and mortar marketing approaches is because it makes more business sense to do it that way, and that has generally helped improve the efficiency and provision of capital around the country. Community development could benefit from some of that capital mobility as well, and the geographic constraints within the CRA exam I think impede some of that capital mobility in the community development context.

We're a national community development organization and we find it sometimes much more efficient to develop financing products for community development on a national basis. But trying to line up all the banks appropriately so we're sure that, you know, each bank is -- we're channeling each bank's credit to their own assessment areas or local regions is very difficult and impedes innovation.

If we took a page out of the community development test that now applies to wholesale and limited-purpose banks -- for them, as long as they are adequately addressing their assessment area's needs, they can get full credit for activities anywhere. And we have used that, channeled credit from what's now Deutschebank, then Bankers Trust, into rural Kentucky where there was no retail bank really motivated and capable to do difficult but high-value investment.

MR. CASANOVA: Dorothy.

MS. BROADMAN: Just to close the loop on that, I think for the institutions that are collecting deposits not through brick and mortar, but spread out around the country, it does

make sense to put them under the wholesale limited-purpose test, because I don't think you could create a nationwide assessment area and then have a large retail bank test. The burden would just be tremendous and I think there would be a huge backlash.

But to address the geographic limitations and to encourage those kinds of institutions to look more broadly than these teeny little assessment areas that they have now I think would be useful to those institutions and also to addressing rural markets, markets that tend to be under-served. It's a good way to get capital into those communities.

So what I'm recommending is for the branchless banks, to put them under the wholesale limited-purpose test format.

MR. VAN TOL: Just to follow-up on that, Dorothy, you wouldn't necessarily have to have a nationwide assessment area. I mean, the assessment area could be tied to where an institution has a significant part of the market, whatever that might --

MS. BROADMAN: But some institutions don't have a concentration.

MR. VAN TOL: Well --

MS. BROADMAN: Many don't. Many are scattered about. For those that have a concentration, I think you're right.

MR. CASANOVA: Elizabeth.

MS. RENUART: I'm not an aficionado on CRA, so I don't know all the definitions and all of that, but one thing I would like to point out about this assessment area, the issue, is at least one example I can think of, but not naming any names, there is a bank in a state that certainly complies with CRA within its assessment area, but then exports very expensive, abusive payday loans to other parts of the nation in contravention of those state laws and limits on usury because it's a national bank.

There should be some consideration and some way to mix this in, not only for payday loans, but other types of abusive loans where lenders are doing fine in their little community in terms of CRA, but they are creating destructive credit in other parts of the nation, and I don't know how that would fit in, but that's a phenomenon that's definitely going on.

MR. CASANOVA: Okay.

Why don't we move our discussion -- we have about ten minutes left or so -- to the performance context discussion. As you know, this is in the CRA performance evaluation of every bank. This performance context provides a description of the institution, the location of the

institution, the size, et cetera. It also provides a description of the assessment area, provides demographic and economic data, and then there's comments that are also in this performance context based on the examiner's interview or discussion with community group members.

So our Committee -- the question there, I guess, that the staff had is basically, is this performance context -- are we seeing these performance contexts to be accurate, complete? And I would say our Committee basically as a consensus felt that, yes, generally they were complete and accurate; however, I think there should have been perhaps -- or we felt there should have been maybe some more discussion with community groups.

In my particular case, using our evaluation, only one community group member was contacted and that member basically discussed the economic activity in our assessment area, and that was all that was in this report.

So I think, Ruhi, you had some comments about that.

MS. MAKER: I mean, I think a couple of comments. One, you know, the more I think about this, you know, all of us around the table are very involved in CRA. You know, the community groups are active and the banks are active. What about that part of the market where there is no advocate there, where the bank is maybe not doing a great job and there is no one there to raise that issue? And does CRA work in those communities? I think that's -- we have to figure out a way of making that happen.

You know, we as a group are very involved, we have been involved for years, but that, I'm told, is somewhat of an anomaly, and, you know, how do we make the regulators more efficient in being out there and talking to the community? I think there's a huge value in having the community be part of that performance context.

And it has changed. I can say quite honestly it used to be a few years ago, nobody would talk about the specific lender; they would say, let's generically talk about what's going on in your community, and there would be this fiction. We would all know that this particular bank was being examined, but nobody could publicly speak in those terms, and that was ridiculous. I think that doesn't happen anymore as far as I am aware. You know, I know it varies. There can be inconsistencies across regulators and even across regions.

But I would definitely encourage -- I think somebody mentioned that there is an interagency database now for community groups, and I think the regulators could have a strong role in saying, when you're out there, you know, making one nominal community contact isn't good

enough, and having the regulators make the contacts with the community and vice-versa, the bank saying, you know, here are these five groups that we do business with. We would really like you to go out and talk to those groups and make sure that those groups are aware, because, you know, yes, it's on the Web page that the exam occurs, but not every community group is up and, you know, things can happen, and, you know, we're watching constantly, and yet suddenly there will be an exam and it will have begun or be about to begin and we will have to quickly get in and get our act together.

So I would say for the financial institutions, that the regulators could encourage the financial institutions, say, well, who do you work with, and then do their own independent investigation. So I would really encourage that.

MR. CASANOVA: Thank you, Ruhi.

Thomas.

MR. FITZGIBBON: I think under the performance context, the input is relatively inconsistent and we tend to end up with really sort of boilerplate language in the exam, in the performance evaluation, and it doesn't really add a lot, frankly, to the color or the texture of the examination.

Although I don't know, because I haven't asked, but I think that the Sunshine rules have put a damper on how community groups respond to or get engaged in providing commentary on the performance of financial institutions in their own market.

There is a rumor mill, if you will, out there that if they do comment, they're going to have to suffer through all the paperwork of getting things out, you know, so that the folks are concerned about that.

I think the other part is that whatever comments do come in, and there aren't many -- I haven't gotten a letter from a community group in five years. Maybe when I get back home, I may have some. And I talk to my colleagues in the business and they don't get letters, either. So there isn't a lot of sort of self-initiated participation on the part of the groups, and when it does come in, it generally doesn't speak to the real rules, so there isn't a lot of good knowledge out there, too.

MR. CASANOVA: Thank you.

Why don't we go to Robin, and then Dorothy.

MS. COFFEY: My comment also related to the interaction between banks and

community groups. We're undergoing numerous exams right now, and specifically one of the regulators said, you know, we don't want to talk to the community groups that you have conversations with because the sense is you're already in communication. We need to talk to those community groups who maybe you've never talked to who may be upset at you because we need to find out why they're upset, and that's -- you know, it's coming from a junior examiner. A lot of us, junior examiners is who we end up dealing with.

But there seems to be a paranoia sometimes on the part of the examiners that they want to find out something you didn't give them, and if you gave them the name of the community groups that you deal with, then they want to talk to somebody that you don't deal with because they want to find out the real story, they don't want to talk to those, you know, that you're in conversations with.

MR. CASANOVA: Dorothy.

MS. BROADMAN: Tommy, I'm really glad you raised that issue because I wasn't in on -- I don't think we discussed that yesterday.

MR. FITZGIBBON: Right.

MS. BROADMAN: But that's important if that's happening. My memory is not great, but I think that there is a carve-out in the Sunshine regulation such that if an agency approaches a community group and asks them and they respond, Sunshine is not triggered.

MR. FITZGIBBON: Right.

MS. BROADMAN: So yesterday, we weren't -- I wasn't thinking in that framework, and we were talking about how the agencies publish the exam list and therefore the community groups could respond. I don't know if that would be sufficient under Sunshine or if this means that the agencies really do need to reach out to community groups and in that process inform them that Sunshine is not being triggered.

MS. MAKER: Sunshine is -- you need an agreement. I mean, I don't think it's triggered by just --

MR. FITZGIBBON: You are right, but --

MS. BROADMAN: You do need an agreement.

MS. MAKER: Right.

MS. BROADMAN: So if this community group has an agreement, they may be hesitant to -- I can't remember the language, but make the comment because then it's triggered.

MR. VAN TOL: But an agreement is any money that you get.

MS. MAKER: Right. Yes. I mean, if you don't take money and you're a community group and you are commenting, you know, there's no reporting requirement triggered.

MS. BROADMAN: That's right, but some community groups do have a financial relationship with institutions.

MR. FITZGIBBON: Right.

MR. CASANOVA: Thomas.

MR. FITZGIBBON: I just wanted to say that there is an apprehension if you are running a three-person community development organization on the South Side of Chicago and you heard at a meeting that there are all of these requirements if you comment on somebody, somebody's CRA performance. It is lack of knowledge, if you will, or lack of understanding of how Sunshine works that I think may have contributed to the lack of self-initiated commentary.

MR. CASANOVA: Okay. We just have a few minutes left. We're going to discuss just briefly examiner training. I will say that --

MS. BROADMAN: Manny, I think it's okay if you go over a little bit.

MR. CASANOVA: Is it? Okay.

Well, with regards to the examiner training, at least what I came out with, and I know Dorothy and Thomas had some points to make on that, is that basically, there needs to be ongoing communication with the examiners.

For example, you know, the examination of our bank took place September 1999. I have had no contact with examiners since that time except, you know, last month when we got -- or last couple of weeks when we got our request letter for the next compliance examination.

There were some points made that, you know, maybe we should have workshops where the regulators, talk about the different provisions in CRA, look at best practices, you know, discuss all that.

So Thomas, you want to share your thoughts?

MR. FITZGIBBON: Yes. I think it's important that we begin the process of reaching out to the examination forces to inform them of what our perception is of how things work and don't work and what some of the examples are of issues that we're running into in terms of interpretation, and that hasn't taken place in a long time.

When the rules first came out and changed, there were efforts on the part of the

regulators to, you know, make more of the industry aware of -- and its own examination force aware of how the rules had changed, and it hasn't taken place on a routine basis in the last several years.

That also, frankly, could benefit the community. The community organizations, the leadership in the communities need to know and be refreshed, if you will, about what the new rules are. So it's outreach, it's education and learning, frankly.

MR. CASANOVA: Okay. Good points.

Earl.

MR. JAROLIMEK: Yes. You know, just to echo some of your comments, Tom, I can recall -- this has been a few years ago now -- when we were being examined under two different agencies, and I was very surprised at the different approach and different reports. I guess from the start to the finish, there were marked differences.

Whether that still exists or not, I can't say from my own experiences because we now are under one supervisory agency, but some peers have suggested that there probably still is a need to maybe look into that a little deeper, and maybe one of the suggestions we could make today would be to survey some banks who've recently had CRA examinations and, you know, ask them very specific questions about the consistency, and perhaps training is a need, perhaps it isn't, but at least we would know some of those results.

MR. CASANOVA: Dorothy.

MS. BROADMAN: I just want to go back a little bit to performance context, and then actually this has a tie-in to examiner training, and back to Governor Bies' question about self-assessment.

Some of the performance contexts that we do have a self-assessment in them, and I think there is a feeling within industry that the performance contexts aren't really -- either aren't being read or aren't being taken seriously because the examiners are so focused on following the procedures that are in front of them.

So one recommendation might be to start -- for institutions that have created a performance context is to start the exam with the performance context so that the first thing that happens is the exam staff reads the performance context and then has a discussion with the institution about it, and from there, the analysis begins.

The tie-in to examiner training is that my experience is that I have actually had

very positive experience with exam staff in the CRA area. I think the people I've interacted with know the CRA rules quite well and how to do a CRA analysis.

But what I find that they are weaker in is just understanding the rest of the story, which is the financial services industry and the market. Especially for examiners who have spent a lot of time doing CRA exams, that's their world, that's the work they do, that's the training they get.

I think they would benefit by having a better understanding just about the financial markets in general outside of CRA so that they would understand the performance context that we're creating, because it's our CRA performance within the context of the financial services industry and the markets in our community.

MR. CASANOVA: Yes, Dorothy, you had made a comment yesterday about the examiners understanding the market, and that is what you're talking about basically. Yes.

Are there any other comments or questions? We would like to conclude here. I want to thank everybody for their participation.

MS. BROADMAN: Thank you, Manny.

We will now take a 15-minute break and reconvene at 11:20.

(Recess.)

MS. BROADMAN: Next on our agenda is a discussion of financial literacy, and that will be led by Earl Jarolimek.

FINANCIAL LITERACY

MR. JAROLIMEK: Thank you, Dorothy.

The Community Affairs and Housing Committee took up the topic of financial literacy yesterday and as you might expect, we achieved a very high degree of consensus. Even though that's not our mission, --

(Laughter.)

MR. JAROLIMEK: -- we nevertheless with this subject managed to do it very easily, and I think it certainly does have a -- consensus is very easy to get in that we all believe it's important. We think this is a very important issue for the Fed to be involved in and, more specifically, we wish to compliment and support what the Fed has done to date. There has been a lot of effort put forward, we recognize that. They have done a lot of things in the way of speeches. Chairman Greenspan, Governors Gramlich and Ferguson and others -- I don't want to leave anyone out, but they have certainly been very active. Our own Gary Stern from the Minneapolis Federal

Reserve has been an active participant for a long time and has spoken out on this issue as well.

We also acknowledge the recognition of how financial literacy contributes to the problems of predatory lending and bankruptcy and we had a unique experience yesterday in hearing from two very qualified speakers on the subject.

Our first one was Dara Duguay from the Jump$tart Coalition. She spoke specifically about that organization's efforts with respect to education of youth, and we had a very interesting discussion and she spoke about their design of a national standard in personal finance and their efforts as a coalition to incorporate those standards within school curriculums.

She also spoke about a twelfth-grader survey that they conducted recently which produced some relatively disappointing results. Fifty percent of the answers were incorrect, not a very outstanding performance in that respect, but it does reveal a need for financial literacy to take place more at the youth level.

Jean Hogarth from the Federal Reserve spoke next. She spoke about financial literacy as it pertains to the adult population, and the survey they conducted recently yielded an average score of about 67 percent. In Jean's opinion, these results and some of the other things they've done seem to validate that there is a relationship between financial knowledge and behavior.

We then entered into our discussion about what suggestions we might encourage the Board to consider in enhancing financial literacy efforts, and we began by discussing the Fed's leadership role.

Robert Cheadle, you had some thoughts with respect to the leadership role and the Fed's efforts.

MR. CHEADLE: Yes. Thank you.

I currently serve as counsel to a tribal legislature, so I recognize the fact that in law, quite often the title of the section has absolutely nothing to do with the section, the material content. But I do appreciate this morning the title on the agenda for this part of the discussion, and I would like to enter it into the record by reading it thus:

"Discussion of issues on learning techniques and the implications for design and delivery of financial literacy training."

I support Earl's comments that we do have a consensus that financial literacy is needed.

I also want to thank you again for honoring me last meeting by allowing me to

speak 15 minutes on the state of financial services in Indian country, and during that presentation, I made recommendations to the Fed regarding their leadership role in presenting financial literacy, and I do appreciate also what you have done and what you are going to do.

You have honored me again by asking me to participate on an advisory committee putting together a conference to be held -- and this is a plug now; everybody write this down --

(Laughter.)

MR. CHEADLE: -- November 18 to 20, Scottsdale, Arizona. The title of the conference sponsored by the Fed is Banking in Indian Country; however, in our discussions, we had broadened that, the scope of that conference a little bit to include Resolving Your Financial Services Needs, and one of those ways might be banking. But we are going to discuss, I think, alternative methods of meeting financial needs in Indian Country.

I think that the format of this conference and its reaching out to tribal leaders who are not children, as Earl introduced our first speaker yesterday as talking about financial literacy for children, we need to provide and the Fed is attempting to provide financial literacy to adults who hold high positions in tribal governments, because we in Indian country need that sort of financial literacy training as well.

Now, the point I want to make today in regards to the design and delivery of financial literacy training is that, one, there is no one solution, that the design has to be broad enough to be able to place in a language understood by many different communities, the Indian community being just one of those.

We talked a lot about new citizens yesterday, new immigrants, and we all know that there are communities that are predominantly of one ethnic origin or another, and all of these communities speak different languages. Even though it might be English, they all understand words to mean different things and they respond to different delivery methods.

So as we go forward and we design the content of financial literacy and the delivery methods, I hope that we keep in mind that there has to be several different solutions aimed at several different markets.

Thank you, Earl.

MR. JAROLIMEK: Thank you, Robert.

Another thing we discussed as a Committee, we agreed there's a lot of

opportunity with customer education right at the point of sale, if you will, of a product, the relationship with a financial institution. Another suggestion was to evaluate how incentives might play a part in helping to encourage financial institutions to play a greater role.

Robin, you had some thoughts on that. Can you share with the group?

MS. COFFEY: Yes. That was -- we were specifically talking about CRA and the service test, which goes back to some of our conversation earlier. In that context, we were talking about how the service test really measures the way you deliver services, but an emphasis is on branch location, hours, ATMs, online banking, and if the service test is 25 percent of your CRA rating, then the things I just mentioned are maybe 90 percent of that 25 percent, and then the last 10 percent is what you do in terms of financial literacy, which may be basic banking, homebuyer counseling.

But we are talking about, you know, how could banks in general do more for financial literacy, and the issue I pointed out dealt more with those banks of which I have very -- we maintain 29 different banking charters. I have 26 banking charters that have no low or moderate income Census tracts in their assessment area, and the low to moderate income population as a whole is probably in the 5 to 10 percent of the entire population in that assessment area.

So therefore when it comes to providing financial literacy or providing some type of education, those banks get no credit for it, at least under CRA, which was another conversation about, you know, they really shouldn't, they're not low-moderate income.

But that got into pretty much what you were talking about previously that with banks being asked to do more and more and with less resources, banks stepping up the plate to provide financial literacy, to provide financial education and not getting any kind of return from it in terms of either CRA credit, in terms of something to help benefit the bottom line, because as much as we may be talking about developing future customers, the lead time is so long, and in today's banking environment, in today's business environment, it's rare that you're looking beyond the next quarter or the next year. You can't afford to start investing in programs that are going to not provide you with a paying customer for five to ten years, which some of these programs that we talked about yesterday are potentially going to do.

MR. JAROLIMEK: You know, just an observation, there are a lot of programs available, I know, through ABA and other associations and several resources. It's just a matter of providing some incentive to perhaps encourage a bank to take that on.

Yes, Russ.

MR. SCHRADER: Well, I want to pick up on your point, and I think it is very important for financial institutions to teach financial literacy, and it's not just for the quarter, I think your point is to have a paying customer, a responsible customer, and it's not only good for business in terms of avoiding writeoffs, but frankly, it's the right thing to do as a business and as a responsible member of the community.

To go back to some of the points that were made earlier on the design and the delivery part, there are a lot of different ways to present these kinds of programs and to make it work for different audiences as well, and it looks like you've really got a handle on some great ones.

As Earl pointed out, there are a lot of different programs that are available to different organizations right now. If I may take a moment to plug one of them, Practical Money Skills is something that Visa has put together in connection with a number of partners, including the Jump Start Coalition, and we have several different ways of doing it.

One is Internet-driven at Access Through Schools. It reaches like 37 million school children right now at practicalmoneyskills.com, and we worked with the National Consumers League, with Jump$tart Coalition and a bunch of others in order to have ways of reaching these children in order to give them access to a K through 12 focused program, and that is one way to reach them very easily up front.

Another way that we've done it is certainly in connection with the call-ups last year following September 11. We realized the need to reach military families because the primary wage earner could have been taken away, called up for active service, sent overseas, and the spouse and the family left behind might not have had the financial literacy and the acumen to do the budgeting of the books.

So what we did was partner with the Reserve Officers Association and we printed up very simple brochures on practical money skills and we distributed them to all 500 military installations across the country. So they were able to access, you know, hard copies of the basic financial literacy skills.

The third way that we've been doing it, and this is where I think the Fed can play an important role, is that Visa member banks have been meeting with a number of agencies like the FTC and the FDIC to talk about how they can be joint partnerships on these kinds of programs. In

particular, the FTC and the FDIC have been very interested in Spanish language versions, which we have put together in order to reach that population as well.

So to build on the Internet, on the language programs, on the physical delivery, as well as to reach a K through 12 program, and the way the people want to be reached, I think it definitely plays an important role in the financial institution's proper role in the community and building the stepping stones that we need, not just for next quarter, but for the next 25 years.

MR. JAROLIMEK: Thanks, Russ.

Ron, you had your hand up.

MR. REITER: Yes. Thank you, Earl.

One of the fundamental problems with teaching financial literacy is the problem of literacy itself in the country. The National Institute for Literacy did an examination to determine the state of literacy in America -- they did this a couple of years ago -- and the lowest level skills that an adult would have would comprise sort of the following things that they could not do:

They could not locate an intersection on a street map. They could not locate two pieces of information in a sports article in a newspaper. They could not calculate the total cost of a purchase from an order form.

Twenty-four percent of adult Americans fall within this category. It's lower in certain states, higher in certain other places, and once you get into a state -- areas that have -- perhaps rural areas or areas where there are recent immigrants or whatever might have even a higher level of basic problems.

Now, they may be fully literate, they may be able to read and write, but yet they are unable, because of their comprehension skills and their reading skills, they are not able to do some of these simple tasks like finding an intersection on a map.

Now, given that as a base on which we are now talking about instruction in financial literacy, it seems to me that there has to be some very careful research done, and perhaps the Fed can help out in this area as well, not only to find out what is sort of the appropriate methods of getting information across to people, taking into consideration, as you pointed out, Bob, the fact that people speak many voices in this country and we really need to address educational programs to maximize the benefit, but also to do some checking afterwards.

We don't know, for example, because there is really no studies out there, how effective brochures are, how effective certain of the programs are. They may all for very well

meaning, but they may not be very effective, and I think we need to try the programs, but I also think we need to do some testing afterwards so we can see where the programs are successful and where they are not, and then take corrective steps to improve the education so that we really have something meaningful here.

Thank you.

MR. JAROLIMEK: Thank you, Ron.

Yes, Pat.

MS. McCOY: Earl, thank you.

I feel very strongly, especially in the long-term, that as we experiment with different styles of delivery, that we will have a better handle on how best to extend financial literacy.

One concern I have in the short-term, however, is that financial literacy might be viewed as a panacea for certain very, very intractable problems for which it really cannot serve as a solution.

One particular population I'm concerned with are people who are extremely vulnerable to targeting in high-pressure marketing situations. Subprime lending abuses might be one example, but there are others. And we need to remember at least in the short-term that financial literacy is incapable of reaching those people -- they are targeted because they are not literate -- and we cannot use that as the sole solution for a problem like that.

GOVERNOR GRAMLICH: Could I make a comment about that? I'm speaking here in the capacity of another organization that I am ex officio chair of, the Neighborhood Reinvestment Corporation. Probably a lot of you know it.

I think we ought to interpret financial literacy fairly broadly here. NRC has what to me is a pretty effective program of whenever they develop a homeowner, you know, provide the credit and so forth, they now ask the homeowners to go through, I think it's eight hours of lending counseling before they can even take title to their house, and it's not perfect, but they are pretty effective at whenever a high-pressure salesman comes around for a refinance deal or something of that sort, the people know at least to check with NRC and maybe take in the term sheet and see what, you know, what this means to them and all that.

So you're right, it's not a panacea, but I think we shouldn't interpret it very narrowly as this program from 2:30 to 3:00 in junior year of high school; I mean, it really has to

work for all types of society and the problems are all over the place, as you note. There are effective programs on the ground out there that really work at this issue.

MS. McCOY: If I may, Governor, yesterday, one of our speakers spoke of the teachable moment, and I feel so strongly that that type of counseling program can be highly effective for that reason -- people are very focused -- and our challenge would then be to try to deliver something similar to homeowners who are not going through these specialized types of programs.

GOVERNOR GRAMLICH: Absolutely. Yes. Yes.

MS. McCOY: One thing that is sometimes considered but it's highly costly is to have, for subprime refinancings, mandatory prior counseling before closing, but at least to consider something like that. --

MR. JAROLIMEK: Ruhi and then Frank.

MS. MAKER: Yes. I would like to echo what Patty stated and actually build on what Governor Gramlich said.

One of the things that we do is we have started to represent victims of high-cost loans. A lot of them are older women and I can tell you right away that having been through many flips, you know, been on their fifth refinance, they finally come to us, and even then, if they're resolicited, which they often are, while we are representing them, the only real solution for them is for them to come to someone like us or to someone like an NRC, a really specialized housing counselor that would tell them what they should do.

I mean, I think we should recognize that the financial literacy is saying, don't trust anyone, don't sign anything, you know, find the right place to go and know who the right person is to give you the answer. I think that's an enormous component.

One other thing, there is a spectrum, I mean there is a spectrum where some things will only be sorted out in one-on-one counseling, and I think we need to recognize that and make sure that that is available.

I would echo Pat's, you know -- a lot of the state legislatures that are passing subprime lending legislation or predatory lending legislation, there is talk of doing mandatory counseling.

But this is highly complex stuff. I mean, I've been looking at some of these loan documents for a little while and I can tell you, despite being an attorney, I usually have to call up

National Consumer Law Center to say, hey, is this the right thing or not? What should we do? I mean, these transactions are complex and we don't really right now have the cadre of housing counselors.

I would love to be able to send a lot of my clients to housing counselors, but right now, they don't exist in Rochester even though we have a Don't Borrow Trouble, and maybe that will change in five years. Right now, you're looking at trying to find a Legal Services or a not-for-profit lawyer who will hopefully look at these papers, and that's not how we're going to solve the problem because there's too many clients and not enough lawyers.

MR. JAROLIMEK: Frank and then Tom.

MR. TORRES: First of all, I think that the efforts on behalf of the financial services industry to educate consumers should be applauded. It's a great role and function that you all have in trying to educate not just your customers, but others as well, although there are some dangers that I see, and one Pat mentioned, and that is -- and I've heard in my time here in Washington -- oh, you don't need to do anything about this problem because we're educating consumers and it's more of a consumer education problem. And in some instances, with regard to predatory lending, when the trade associations come to us and say, we've got this great education program, and I read through it, I say, do you understand that you're warning the consumer against some of the practices of your own members. You know, what's wrong with this picture? So in some instances, education alone won't do it and shouldn't take the place of that.

I know groups or companies like Fannie and -- I don't know about Freddie, but Fannie at least has started a program where they are trying to help consumers in predatory loans get out of them, unwind them. I believe as part of that program, they are educating those consumers on how to stick with the good loans and not become a target again.

One last point on the education towards the youth. We're sometimes skeptical of commercialization in the classroom, but the altruistic efforts of companies to go into the classroom to educate, if it doesn't have this shadow of trying to be an ad for the particular product, is a good one, although a few years ago, in the course of working on the bankruptcy bill, we did get a brochure from a credit card industry seminar, and the title of it was "Targeting Teens," and the little caption read, "You never forget your first love or your first credit card," which was a little bit disconcerting. I think at the end of the day, the credit card was probably a lot more expensive than the date.

(Laughter.)

MR. TORRES: So I think there's a good balance that can be struck here with regards to the education.

MR. JAROLIMEK: Tom and then Teresa.

MR. FITZGIBBON: My focus really is two things. One is, I think that, and we discussed this yesterday as well, there really are -- when you talk about the learning or the teaching point, you really have two separate learning opportunities. One is transactional, and that's the point at which a customer is buying something, whether it's an automobile or a house or refinancing their current, and the other is behavioral, which is really the standards of behavior that financial literacy in general can give people in terms of their skill set, and I think there are different approaches to those two types of learning experiences and require different skill sets and different pieces of information that can help people make better decisions.

One such initiative now underway in Chicago is the Homeownership Preservation Initiative, which is trying to keep people in homeownership rather than to leave them subject to the vagaries of the marketplace.

The second was, to go back to the learning experience in general, I brought up the point that one of the things that the industry, the banking industry could do itself, and it's something I'm going to take home with me, part of yesterday's conversation, is that I have nearly 500 people who report to me, and I would venture to guess that probably two-thirds of them are tellers or customer service associates, and I would venture to guess that most of them are illiterate when it comes to the behaviors of the marketplace and how they should interact in that process.

So looking into our own institutions to try to provide the level of learning so that our own people can make good decisions in their own personal lives I think is really important, and in order to do that, I think both the regulators and the industry advocates, the ABA and others, should help us through the AIB programs and the Institute for Financial Education to develop train-the-trainer programs in addition to the other components of financial literacy that are there.

MR. JAROLIMEK: Teresa and then we will go over to this side.

MS. BRYCE: My comment really goes partially to Governor Gramlich's point about this being a broad effort and the need for broadness, but also in part to what you're called behavioral training, because my view had always been that -- and clearly we need more of the targeted transactional training, but my view of financial literacy had always been the need to really

help people understand how to manage their finances and what good credit means, because when you're in the mortgage industry and you start seeing people -- at first it was people being denied for credit because they didn't understand that if they didn't pay their rent on time, you know, it wasn't just a consequence of paying it before you get evicted, but rather to pay it on time so that you have a good credit record, so that when you do try to buy your first home, you're viewed as having good credit.

So partially it was that. Now with the evolution of the subprime market, it's people ending up in higher-cost credit.

So my view is that if you use financial literacy as a way to train people on how to use credit and what it is, then you also teach them what the behaviors are that allow them to be in the prime market and hopefully avoid being in the subprime market or being subject to predatory lending practices in the first place.

MR. JAROLIMEK: Robert, Agnes and Hubert.

MR. CHEADLE: Thank you.

I did want to say that NRC has been very successful in Indian country doing a lot of literacy training, and I appreciate that. The reason they, in my opinion, have been successful is because they haven't gone in there as white shirts from Washington or Houston or Denver, you know, out here to help these poor Indians. What they have done is trained the trainer and the trainer is an Indian, and so that Indian can take their message, NRC's message or the financial literacy training message and put it in the culturally sensitive delivery method that needs to be done.

I also wanted to comment on the transactional and behavioral issues. In Indian country, we need more than that. We need, what is a bank?

I told an anecdote yesterday about one very large reservation that didn't have any banking on it. In fact, the reservation is larger than eight states, to tell you the relative size of it, and it had no bank whatsoever until the early '90s when it had one branch placed in its capital city.

Then in the later '90s, four branches were opened throughout the nation in strategic places, and the bank bought single-wide trailers and stuck them out in parking lots and shopping centers, said, okay, here's your bank.

There were no deposits being made, and they said, well, why, local community, are you not making deposits? And they said, well, number one, we don't know what a bank does or what it can do for us; and number two, you didn't take the wheels off the trailer, and we're not going

to go put our money in a bank that a pickup truck can hook onto and drive off in the middle of the night.

(Laughter.)

MR. CHEADLE: So as we talk about the sophisticated issues of behavioral and transactional, let's don't forget the very basics. I mean, let's go all the way back.

I also wanted to mention something that Manny, I'm sure, knows a lot more than I do, the Las Colonnias. Those people have no idea what the finance system is, and when they are given an opportunity on a contract or deed to own a little piece of land, oh, by the way, electricity is 20 miles away and water is, you know, 50 miles away -- you know, they need tremendous -- and these are new immigrants -- they need tremendous amounts of basic financial literacy training as well as transactional and behavioral training.

MR. JAROLIMEK: That story kind of gives a whole new meaning to mobile branch, doesn't it?

MR. CHEADLE: Yes.

(Laughter.)

MR. JAROLIMEK: Agnes, Hubert and then Janie.

MS. BUNDY SCANLAN: Just a comment on the discussion of how this needs to be a broad issue with perhaps a focused implication, and that goes to Ron's point regarding surveying and also really the needs of some localities.

For instance, with a large institution that has branches and operations in rural as well as urban areas, you really need to understand what your market needs -- perhaps more partnering with community based organizations, more research to understand those needs, and then try and use that to actually fulfill the needs in the particular locality.

Also, there are several institutions that do have branches within a school. I know in one of our rural areas where there wasn't a branch locally, we did work with a vocational school and had a branch in it where we provided financial literacy and education, and we didn't have marketing materials such as those that Frank mentioned, but we did try to educate the teenagers about running a branch.

So I think it's a full spectrum, it is broad, but perhaps institutions can partner more with community based organizations to have that focused approach within their own areas.

MR. JAROLIMEK: Hubert.

MR. VAN TOL: I would like to echo some of what my consumer colleagues said about being somewhat cautionary about viewing financial literacy as a panacea.

I think, you know, whenever we get talking about predatory lending, the topic of financial literacy comes up. When there's a spate of bank robberies, we don't hear much talk about educating bank tellers about how better to deal with bank robbery. You know, in the words of Woody Guthrie, some people rob you with a six-gun and some with a fountain pen. So I think let's not lose sight of the regulatory powers and the legislative powers that the Fed has to deal with this issue.

There has been this recent exchange of letters between Governor Greenspan and Chairman -- or Ranking Member LaFalce about unfair and deceptive practices, and I would venture to say that if the Fed came down like a ton of bricks on a couple of predatory lenders, it would do more than $100 million worth of financial literacy training to begin to end some of these practices.

MR. FITZGIBBON: That is real behavior training. The industry supports that, too.

MR. JAROLIMEK: Janie, you had some thoughts?

MS. BARRERA: Yes. This has to do with what Ron was talking about in terms of surveying and also behavioral change.

When Jean gave her presentation yesterday, she discussed that they were doing some partnerships with DOD, for instance, and there was also some discussion about even doing something with the Department of Education and seeing how some kind of collaboration could take place.

But specifically on the DOD study was that what they want to do is go into, I think it was the Marines and do some financial literacy with recruits that are coming in, and as I was thinking about that, I thought, wow, you know, that is really an option for the poor. I hate it say it, but, you know, a lot of poor young people do go into the Service. I mean, that is their way of receiving some kind of education.

So I thought, wow, you know, you have a captured market, you have a controlled group, and you can go with them for four years and see what kind of change does take place when one does receive some kind of financial literacy, everything from how to reconcile your checkbook, but also what to do with your retirement funds. That was something that we brought out yesterday as well, you know, with that, you know, becoming part of the marketplace now and not -- you

know, there are less and less pension plans and so on, that that's another key element to financial literacy. So I just want to point that out.

MR. JAROLIMEK: In the interest of time, I will take a couple more -- Ken and then Dorothy -- and we'll have to close, I'm afraid.

Ken.

MR. BORDELON: I would like to add support and to echo on the broad concept of financial literacy. In credit unions, we tend to look at this also as the informed consumer viewpoint in that in the normal course of business, it's very common practice to give our members, in shopping for a car, for example, the suggested retail price for the new vehicle, the actual dealer's cost, and if they've got a trade-in, it's customary to give them an NADA value for their used car, so they are informed going into the deal.

I know we've talked a lot about mortgage lending, but consumer lending dealing with basic transportation to get to work is very important, also. I wish we could educate them as well on the deal on the zero percent financing. Maybe that's a Reg. Z issue that we won't discuss here today.

But in dealing with the partnerships, we partner with NEFI, the National Endowment for Financial Education, in the schools together with CCCS. We're trying to implement financial literacy in the schools as part of the curriculum.

The problem there, and I didn't get the opportunity to listen to the Jump$tart presentation, is that I think we have to remember that our teachers, especially in public schools, are really under the gun with all of this accountability, testing, and to introduce new programs into the public schools -- I think we and the Board through their leadership get to the administrators of the school to reiterate how important this is, because the teachers are really, I mean, suffering with a very big workload.

Down on the ground, we have about 80 credit unions now that are overseeing some 250 in-school credit union branches run by high school students, and I feel, you know, like Agnes was referring to, this is a good way to practically work with the educational process to endear the financial literacy. But I do applaud the Board for bringing the attention to this matter, and thank you.

MR. JAROLIMEK: Dorothy.

MS. BROADMAN: Great discussion. I agree with so much of what has been

said and I encourage the Board to stay actively involved in this important issue.

I think this field could benefit from some consensus around what is important for people to learn and at what stage of life, and I don't think that we have that yet, just even from my experiences yesterday and today.

The Jump$tart survey that she went through, that has expectations that high school students will understand what pension plans are, what compounding interest is, that the stock market is the right place to invest your money.

Jean talked to us about the importance of people understanding where to get information, and Ruhi made a comment -- I don't think in this meeting, but outside of this meeting -- that people need to understand that you don't get information from people who are trying to sell you something.

So I think it would be very helpful, and I don't know if the Fed could take a leadership position on this, but to put some definition about what is important to teach, because I see this as kind of a scattered-shot approach and people are doing different things, and I sometimes wonder if even the bankers going out into these schools are really spending the time wisely with the kids given where they really are in their level of understanding.

So I think that kind of thing would be very helpful, and then the other issue which has been raised is assistance in finding out what is most effective given the fact that we have limited resources, how really can we best approach this.

MR. JAROLIMEK: All right. Very good. Thank you. Good discussion. Thanks for your participation.

With that, I will turn it back over to you, Dorothy.

MS. BROADMAN: We are ready to move into the Members Forum. We will be hearing from two members. We're going to start with Tommy FitzGibbon, who will talk to us about what has been going on in Chicago in response to predatory lending.

MEMBERS FORUM

MR. FITZGIBBON: There is a handout which is in the back of the room. I don't know if everybody has gotten one here. You may want to bring them to the -- if somebody could bring them to the Committee members, we can just follow through. That way, I'll get through this in ten or twelve minutes.

About two years ago, a group of financial institutions met in my office to talk

about the issues related to predatory lending and the perception in the marketplace that bankers were leading the way in our own market in preying on people who are vulnerable.

In essence, the bankers, in partnership with a number of community based organizations -- I'll name just a few, but the National Training and Information Center, Neighborhood Housing Services of Chicago, and the Legal Assistance Foundation -- helped to craft a response which was supported by the total community.

We will go through just a quick definition of the problem in our market. It was primarily elderly householders; transactions with unusual characteristics, things like single premium life policies, short-term balloon loans, high prepayment penalties, flipping, stuffing or packing. I don't know if you've all heard all those acronyms, but in essence, it was a bad loan.

In addition to that, we saw things where home improvements were incomplete, collusion between home improvement contractors and unscrupulous mortgage brokers, incomplete disclosures, disclosures that were, quote/unquote, "given at the table" even if they were accurate, and high-rate, high-fee transactions where the borrower really in essence was incapable of making the payments, and transactions in which there was no real financial benefit to the borrower.

The response to the problem, frankly, fostered in the financial community was to really facilitate a dialogue among the interested parties, create awareness to the industry, the banking industry that it was inherently in their own self-interest to participate in creating a resolution to the market reaction to the predatory lending that was going on.

Really, we had significant investments that were already in place. The leadership of the financial community for years, even prior to CRA but especially since CRA, has spent a lot of money putting and making credit available in these markets, and it was important for us to protect that.

The process is really to commit early on, to get consensus among the financial industry to commit financially to it, both time, talent and treasury, to making sure it happened, and to negotiate new alliances.

It was really important for us to see at our board table the National Training and Information Center, Gale Cincotta, along with the city -- the late Gale Cincotta, bless her soul -- and the municipality, the city, together with Neighborhood Housing Services, the Legal Assistance Foundation, and other community associations who had an interest in resolving the issue.

So the essence was to identify what alternatives could be created to develop and

generate underwriting guidelines for a loan program called NORMAL, the acronym meaning Neighborhood Organization Recovery Mortgage Assistance Loan -- we like those acronyms; I spent ten years in Washington, so I learned how to put them together -- and to put together acceptable general underwriting guidelines so that all of the participating lenders as well as Neighborhood Housing Services and the community at large understood what would qualify.

We created working documents, loan sale and servicing agreements, trust documents, and got commitment letters from the financial institutions and the city to participate.

The partnership essentially in terms of operating this, although there were many other people, many other organizations who participated in developing -- I guess that's the right word -- customers for the program, but finding people that we could help resolve the issue for them: Neighborhood Housing Services, the City of Chicago, the Legal Assistance Foundation and a consortia of about 14 or 15 financial institutions.

The roles of the partners were well defined, NHS being the counselor, negotiator, providing the lending and servicing loans; the City of Chicago, community awareness programs, finding a way to create a loan loss reserve, and providing some operating support for NHS and the Legal Assistance Foundation; LAF doing a lot of advocacy work, referral document review -- I know we were talking about that before -- and really suing some of the financial institutions who participated in these terrible practices; and the banks, getting the banks to commit $2 million at market rate or slightly below.

Initially, we got ten banks to also provide $2,000 a year in annual operating support so that the program itself could continue. The banks in effect pay for every loan that's originated. Each of the participating banks pays $100 to NHS for every loan that's originated.

The city put up $1.2 million in a loan loss reserve, providing, in effect, a safe and sound investment.

The structure of this transaction was reviewed by the FDIC safety and soundness examiners and found to fit, because we didn't want the financial institutions on the one hand to be involved in something that was very well constructed and then have the SS troops, the safety and soundness guys, come in and make them set up a loan loss reserve themselves or write it off. The City also provided a part of the operating support.

The role of the city was to provide a campaign of public awareness, which they did, together with a phone -- a way for people to call in and get referred to an organization that

would help them. They also got engaged in and put together I think the first municipal legislation that discouraged lenders from engaging in the practice. In essence, what lenders who wanted to do business with the city had to do was to pledge that they weren't engaged in or investing in or any of their affiliates weren't engaged or investing in loans that were predatory in nature, and the city also played a role in the advocacy.

We've been operating for about two years. Robin Coffey sits on the committee with me, the Loan Review Committee. The lenders review each of the loans that are set up to do this.

Essentially, the NHS originates the loan on behalf of the investors, services the loan for twelve to 18 months, and then one of the participating lenders will buy the loan out of the pool. So it's designed to be an interim step to get people whose credit has been damaged -- we expect their credit to be damaged -- and get them back on track, if you will, in terms of their credit behavior, and then at some point one of the lenders will buy the loan out of that.

Up to this point, we've originated about 50 loans, but that's not the end of the story. We've resolved well in excess of 200 cases. So it's not that we have to make a loan on every deal, but the fact that you've got an advocacy organization and you've got someone who is capable of negotiating with a current owner of a loan to negotiate short sales or to negotiate restructuring the transactions has resolved four or five times as many customer problems as the ones that we've had to actually make a loan on.

To give you an idea of the servicing side of this, not a single one of those loans is delinquent, none of them have gone into default, and we expect fully that these customers will be part of the mainstream of credit in the future and will have more information so that they can make better decisions in the future.

With that, that is the conclusion. How did I do? Twelve minutes.

GOVERNOR GRAMLICH: Could I --

MR. FITZGIBBON: Yes. Sure.

GOVERNOR GRAMLICH: Where do your homeowners come from? I mean, how do they --

MR. FITZGIBBON: The referrals?

GOVERNOR GRAMLICH: Yes.

MR. FITZGIBBON: The referrals come from a couple of areas. One is the

Federal Reserve Bank of Chicago several years ago, 1996 if I remember correctly, set up the Foreclosure Intervention Program, in effect sponsored the banks to help work on issues related to customers who were facing foreclosure, and so that program is still alive and there are a number of financial institutions who continue to participate in that, referring people who have problems and are ending up in foreclosure through a variety of different local organizations. So there are some that come in through that, some come in from Legal Assistance Foundation, some come in from the 311 number, which is the City of Chicago's non-emergency number, and they are referred to any number of the organizations who work with us in this program, and some come in on their own. They just, you know, they are about ready to give up, and so they call Neighborhood Housing Services or they'll call their local bank and say, I don't know what to do, I'm dealing with this lender and I can't seem to find out what's going on.

Dorothy.

MS. BROADMAN: I'm wondering if you can just walk us through what one of these transactions look like just to give us some more information. I'm wondering, is it that the existing lender is taking a discount on the payoff of the loan because they've been identified, and is it also becoming affordable because the interest rate on the loan is being reduced substantially or modestly?

MR. FITZGIBBON: Well, it's the terms --

MS. BROADMAN: How does it work?

MR. FITZGIBBON: Yes. I will give you a typical example. We have an 82-year-old African-American widow who lives on the South Side of Chicago who, because she got involved in a rehab to replace her roof four years ago, has suddenly, through flipping and some other things, gotten into a position where she has a loan that she literally can't pay off and she can't make the monthly payments on simply because of the construct of the loan itself.

They may come to us as advocates in two different ways:

One, on the legal side, take a look at the documents of the several transactions that may be involved to ensure that if there are issues related to disclosures or the legality of the loan in the first place, there may be challenges that could be made.

Second is that the customer will be given financial counseling one-on-one, will be assigned a counselor, and we will help them to work through the issues to ensure that it doesn't happen again.

Third is that one of the counselors from Neighborhood Housing Services will be in touch with the current owner and servicer, who may be two different people, of the existing loan to get them to the point where they understand that in a lot of cases, the value of the property is not there to support it, and that it's in their own best interest to restructure the loan and to remove those things that are on the loan that are difficult if not impossible for the customer to live up to.

In many cases, four or five times as many as we actually make a loan, the lender or owner of the loan recognizes that -- well, two things. One is reputational risk. Do we want to start talking about the XYZ Company that owns this. And the second is financial, is that it probably makes more sense right now to take a 30 percent discount on the existing principal that they have and restructure this loan so that it can actually be paid by the customer.

If that's not possible, NHS will step in and actually pay off the loan at discount and originate a loan that fits standard criteria that the customer can actually afford to make the payments.

MS. RENUART: I just wanted to -- if I may be so bold as to augment something Tommy said and highlight it, and that is I've been following your program closely through the Legal Assistance Foundation and what is I think one of the most important components, in addition to the very good product you have for people when you do refinance them out of these loans, is the cram-down of the principal, because otherwise, without the Legal Assistance Foundation or the housing counselors who are engaged in those activities, either because it's illegal or because they convince the current lender to do that, and you then refinance that into this new normal product, if you don't cram it down, --

MR. FITZGIBBON: Right.

MS. RENUART: -- you're simply providing another secondary market source of funding for predatory lenders.

MR. FITZGIBBON: That's sort of actually inherent in it. We don't want to do that. We're not -- that's not the purpose of it.

MS. RENUART: I'm happy to see that yours was the first program in the country to create an alternative loan product. Freddie Mac has followed and Fannie Material is expanding that around the country, and both are considering the same dynamic as critical to the whole process so that they aren't funding on the secondary market predatory loans.

MR. FITZGIBBON: Right.

Earl. Go ahead, Earl.

MR. JAROLIMEK: The City of Chicago's participating in the loan loss reserve, --

MR. FITZGIBBON: Correct.

MR. JAROLIMEK: -- is that something that you would characterize as unique, or have you seen that in other --

MR. FITZGIBBON: Well, I would say it was unique. The city wanted to participate, and so we constructed this as a way which the capital itself could be deployed in a way that would allow them to recover it, so they own 6 percent of every loan, and so there wouldn't be a -- that they actually would benefit, if you will, from this program down the road. I have not seen, in my lifetime, I haven't seen a program, a single-family program where the guarantee was there, but they really wanted to participate in this.

MR. HAWKINS: Let me use an example and make sure I'm understanding what you're saying, Thomas, about this buydown is in the best interest of the lending institution. It might be in some instances.

For example, we had somebody who had a house that had maybe a $60,000 balance. Well, if you write that down 30 percent to 42, they can service that and restructure it.

What would be my incentive as a financial institution to go along with that even though they could service at 42 if the balance is 60 to me if the value of that property, say, were 80- or 90,000?

MR. FITZGIBBON: That's a tougher sell than --

(Laughter.)

MR. FITZGIBBON: That's a tougher sell. But I can tell you that if they've been flipped maybe even just once, in most of the Chicago market, is that they are at 120 percent LTV. So you go to them and say, okay, after you do the six-month foreclosure and after you have to do the board-up and after you have to do the eviction and after you experience legal expenses, you're going to be down to where this customer was before you started this process, so why not wake up and take the discount today?

MR. HAWKINS: That's interesting that they don't realize that up front before they even get into that lending situation. That's the way they're doing business in Chicago?

(Laughter.)

MR. FITZGIBBON: Well, I'll tell you, off the record, I will tell you about the house two weeks ago that we rehabbed at 1638 South Christiana where a dead person actually bought a house. So we'll talk about collusion and some of those other things. Yes, in Chicago, if you're dead, you can vote in the primary election and in one general election, but I never saw --

(Laughter.)

MR. FITZGIBBON: I never saw a dead person buy a house until I saw the house at 1638 South Christiana. So it is that sort of, unfortunately, the unfettered, unscrupulous mortgage brokers who continue to rip off our neighborhoods and rip off our neighbors as well.

MS. MAKER: Tom, if I can just speak to Rochester, New York, I mean, I have 100, 200, 300, 400 percent loan to values, and, I mean, I have the documents in my office. I know you're --

MR. HAWKINS: Banks making those loans?

MR. FITZGIBBON: No.

MS. MAKER: Well, finance companies.

MR. FITZGIBBON: Brokers sold to the secondary market.

MS. MAKER: Right.

MR. FITZGIBBON: Not Fannie or Freddie.

MS. MAKER: And we've had cram-downs in both situations where the loan to value was upside down and where there was equity, and in those cases, simply, you know, you violated RSPA, you did this, that and the other, you know, we try to settle them, and when they don't, we raise defenses or we file a federal lawsuit, and then, you know, suddenly they come down and they want to do a principal reduction. That is what -- you know, I mean, it's very, very prevalent. I mean, both Elizabeth and I are on a list server, and about ten times a day, we get a fact pattern which is -- and it's all over the country.

So I think that, you know, we're going to be seeing -- I think some of this stuff is going to start emerging a lot more than we've even begun to realize how much is out there.

MR. FITZGIBBON: At least what has happened I think is that the securities industry has had a wake-up call.

MS. MAKER: Yes.

MR. FITZGIBBON: And they are not letting all these cockroaches get in with the butterflies in the securities, and the fact, I think, that that source of capital is now more

interested in making sure that these loans meet normal standards I think will perhaps dampen some of that.

MS. MAKER: But we may see a huge explosion in the foreclosures before the cleanup occurs, because all these things that are being flipped, flipped, flipped, suddenly there's nowhere for them to go.

MR. FITZGIBBON: Dorothy, you run this, would you?

(Laughter.)

MS. BROADMAN: We have time maybe for two more, so Buzz, did you want to say something?

MR. ROBERTS: Are there other programs around the country that are doing similar things?

MR. FITZGIBBON: To my knowledge, there are two or three like this in other parts of the country. The Federal Reserve Bank of Philadelphia did a tech brief, which is in the package as well, basically to say, here's how this works, and if you're thinking about doing this in your market, here are the things that you might want to follow.

I've been out probably to maybe 15 or 20 communities -- Cleveland was the last one, basically is looking at it right now.

GOVERNOR GRAMLICH: I think Neighborhood Reinvestment would have a list of who's doing what in what city.

MR. FITZGIBBON: Right.

MS. MAKER: New York City has one similar, the city again is in there, and Buffalo, Rochester, we're all looking to do similar things. So we want you to come talk to our bankers, Tommy.

MR. FITZGIBBON: Okay.

(Laughter.)

MR. FITZGIBBON: Like I say, the documents, all the documents, all the construct, all the underwriting guidelines, everything is available for free. All you got to do is just send an e-mail and we will send it back to you.

MS. BROADMAN: I have to ask this. It's a two-year program and you've -- 50 loans, 200 -- so 250 cases total, or 200 total?

MR. FITZGIBBON: Right.

MS. BROADMAN: Two years. Why aren't there more?

MR. FITZGIBBON: Well, I think to a certain degree because people -- it is getting the word out, it still is getting the word out that there is an organization that's willing to do something to help you, and people come to a certain degree too late. The sheriff sale is Tuesday. Okay. What are we going to do now? So it is that desperation, and what we're trying to do, both through the general medium, through the financial industry participation, is to tell people in advance that if they run into trouble, come and see us.

MS. BROADMAN: Well, I am going to have to wrap it up because we have another speaker, but thank you, Tommy. Very, very interesting.

(Applause.)

MS. BROADMAN: Now we're going to hear from Oscar Marquis on identity theft and credit fraud.

MR. MARQUIS: Thank you very much.

My name is Oscar Marquis, I am an attorney with Hunton & Williams, so you might wonder what am I doing here?

(Laughter.)

MR. MARQUIS: But I was with TransUnion for almost 25 years and general counsel for about 15, so I've been involved in credit fraud and identity theft issues for a long time.

So I was there when we first started talking and realizing that there was a fraud issue involving credit cards. Credit cards were just getting generated into -- pushed into the economy, getting used more and more, and the initial way the fraudsters and criminals were committing credit card fraud was by making their own cards. They had these machines that made credit cards that looked like the real thing; it was called white plastic. It was a fairly big industry, and they put numbers on it and actually got away with using fake credit cards for a while. There wasn't this instantaneous authorization process in the communications network.

So industry thought they were losing too much, they were losing too much money, and came up with some solutions. They initially added a magnetic stripe on the back of the credit card which contained the information that was on the front, the name and the account number basically. Well, the fraudsters quickly figured that out and they added the magnetic stripe on the back with the same information.

So then the credit card industry added the hologram, and for some reason, that

worked. The technology was not there to duplicate the hologram, so the white plastic industry went out of business. But the fraudsters didn't stop there, they didn't stop committing crime, they started applying for credit. So the next step, the next stage of credit card fraud was the fraudsters applying for credit using fake numbers, fake names, fake addresses, and they got credit cards and started using them, or they used stolen cards.

Well, industry, the credit card issuers, didn't like this either. They were losing a lot of money as a result, so they developed various programs in conjunction with credit bureaus and other fraud prevention or detectives or whatever. They started verifying the social security number against numbers actually issued or against the Social Security Administration Death Master File to see if this was a dead person or did the algorithm meet the parameters to make it a legitimate social security number. And the way fraudsters made these credit applications was they had the credit card sent to a fake address or to a mail drop. They would have it sent to 100 Main Street, Apartment 56, which was the address of the post office and the post office box, and it was delivered by the post office.

But the credit card issuer may not be -- may be a little concerned about sending a credit card to a post office box, so the credit bureaus developed databases of mail drops, of prisons, of post offices, of other mail drop companies, and then they developed instant authorization, the instant authorization process and they developed algorithms to do comparisons of information on the application.

So what is the next stage? The fraudsters didn't stop there. They still wanted to make this easy money, and it's a non-violent crime. So the next stage is identity theft. They started -- the criminals started getting information on real consumers and started using them. They would apply for a driver's license number or get other identification cards using a real person's name, address and social security number. We just learned yesterday at a hearing in Washington, up on the Hill, that the Social Security Administration issued about 100,000 social security numbers last year wrongly to people who should not have received them.

Now, when you make a -- but when you apply for credit, a name and address is not enough. It's too easy to falsify that or to use someone else's, so they need additional information. They added the social security number.

Now, you've got to remember, most credit applications are not in person, they are by mail, so you can't look at any identifier, you can't look at a picture, you can't use biometrics, you

can't use anything, so it still seems to be a fairly easy way for fraudsters to commit the crime.

You can use other identifiers. You can ask for a mother's maiden name, you can ask for a driver's license number, but the fraudster can fake that because there's no way to verify that the mother's maiden name I give is right or wrong. You can't match it against another database. Really all that's available that can be matched to authenticate is name, address and social, which is available in another database, which, of course, creates a conflict between privacy and security.

So legislators are up in arms about this. You read about it in the media all the time, identity theft is rampant, so they proposed various solutions, like restricting the availability of a social security number and not have it on public records.

Well, the problem with not having a social security number on a bankruptcy record is then all you have is a name and maybe an address on the bankruptcy record. You can't put it into -- you can't match it with the right individual. So people who went bankrupt would not have a bankruptcy showing up on their credit report because it can't be matched. That also would have an impact on the safety and soundless of the lending process.

Some legislation would prohibit requesting social security numbers, or there was a proposal in California a few years ago that when a consumer applies for instant credit, there have to be four identifiers that match, that the consumer provides on the application that matches something in the credit-reporting database. Well, there's name, there's address, there's social security number. What is the fourth? There's driver's license number, mother's maiden name. As I said you can't use that to verify because it's not there. So ultimately, the legislation was passed but requires only three matches, but the problem with three matches is when someone -- when a woman marries or gets divorced and changes her name, there is no longer a match on the name, so then you just have -- and maybe not a match on the address, so you have an adverse impact on credit applications.

But what is industry doing about this problem? Obviously they don't like losing money to identity theft fraudsters, so there are various processes and procedures and solutions in the works.

Of course, the activation procedure is fairly effective. When a credit card is mailed to you, you have to call up and have it activated by providing some personal information, but again, it has to be something that they know that only you know or, you know, or -- well, hopefully only you know.

(Laughter.)

MR. MARQUIS: Industry is working on a streamlined process to help consumers who are victims, help them fix it more quickly, identify that they really are the victims. The problem there is, of course, credit bureaus get claims of identity theft victimhood and about 30, 35 percent of those who claim to be victims are actually consumers trying to avoid paying bills that they actually owe, so you can't just accept their word for it.

But there are other systems. There are fraud prevention systems that match the telephone number you provide on the application with the employment telephone number to see if they're close enough, to see if it makes sense for someone who lives at this telephone number to work at this one, and there are various other procedures that we don't want to go into in public.

So as a result, identity theft is rampant, or is it? It's certainly growing, but the numbers indicate it's growing -- in part, it's new, it's a new crime. We just started counting, and because of the publicity, many victims of any kind of fraud or credit fraud, claim of identity theft, gets put into the category of identity theft, so we don't really know what the real numbers are.

The GSA recently produced a study showing there were 90,000 victims in 2001. The Federal Trade Commission had -- or the Consumer Reporting Agencies reported 90,000 victims. The Federal Trade Commission in their clearinghouse had 94,000 calls in two years, but they also asked questions about what was your injury, what was your cost, and only about 2.8 percent of those had out-of-pocket losses, and 3.7 percent claimed to have lost time resolving the problem. The Social Security Administration reported 65,000 calls and the FBI reported 645 arrests in 2000, which was less than the year before. Dollar losses, of course, Visa and Mastercard reported $114 million in losses.

So there are financial losses and there are victims, but maybe not -- at least the numbers don't indicate that they are as great as we sometimes read in the media, at least based on the GSA study, which is the only definitive study that I have seen.

But the publicity about identity theft is leading to all kinds of privacy legislative proposals, and I wonder whether they are all justified by the numbers, and many of those proposals, as I indicated before, tend to be counterproductive because by not permitting data to be available in certain databases, it makes it easier to commit identity theft, it makes it harder to authenticate the individual. On the other hand, by allowing it to be available in more places, it's easier for someone to get it and commit identity theft. So there is this balance.

I think, in conclusion, we need to remember that identity theft harms innocent individuals who had nothing to do with it. They didn't know it happened to them. There is nothing they could have done often to prevent it from happening. They couldn't have locked their door better or do what you do to avoid burglaries.

I think the financial literacy project should include educating consumers about protecting their personal information. Don't ever provide your personal information to someone who calls you, but you can provide it if you are calling to make a credit purchase or an application.

But there is this tension between privacy and security and convenience. Consumers want to be able to get a car and drive it home that day or buy that 52-inch TV and take it home that day, and that has an impact -- that's convenience, but has an impact on security and identity theft because it's easier for someone to commit identity theft if that's what they want to do. It can be stopped by making the consumer wait a week and have everything checked out and verified, but that impacts convenience, which consumers don't want. And I think it's important to avoid this counterproductive legislation.

Thank you.

(Applause.)

MS. BROADMAN: We do have time for a couple of questions or comments if there are any.

MS. MAKER: Oscar, I have a question, which is sometimes it seems, and this actually happened to us, is you don't lose your credit card, but purchases show up on the bill. You know, in our case, they were actually made in Canada, and we never lost our credit card, so we never reported it stolen, and we have no idea how that happened. One guess is, of course, the Internet. It was, I think, around Christmas and we had used the Internet. So isn't that like a huge potential -- almost a bigger danger for the future? I don't fully understand how, you know -- what happened.

MR. MARQUIS: Well, I don't know how it happened in your case. I haven't seen instances where the social security number was taken off the Internet.

MS. MAKER: No, no, not the social security number; the credit card was -- how can the card be used, how was a card used when the card was never stolen?

MR. MARQUIS: Well, if someone gets the number off a credit slip.

MS. MAKER: I see.

MR. MARQUIS: And there is legislation pending in many states and I think 18 have passed legislation that prohibits the printing of the account number on the receipt.

MS. MAKER: I see. Okay.

MR. MARQUIS: So if someone sees the receipt at a restaurant, at a store, they could potentially use that.

MS. MAKER: Oh, I see. But then they would --

GOVERNOR GRAMLICH: They use it when they phone it in?

MR. MARQUIS: Yes.

GOVERNOR GRAMLICH: Because they wouldn't have the card.

MR. MARQUIS: Right. Although there are procedures in place to try to prevent that as well because they always ask is the billing address the same as the mailing address.

MR. MARQUIS: But these were used -- the card was used at like a Home Depot or something like that in Canada, so we never figured out how -- they have replicated the card, having stolen the slip? How can that work?

MR. SCHRADER: It's possible the very most sophisticated people now have ways of duping the mag stripe, and you read about this, where they can -- a waiter, if the card is out of your possession, they go into the back to run the slip, may run it through a little box that will capture that card, which can then be replicated and then be used. That's an extremely sophisticated device and is rare, but, you know, it's possible. It's impossible to say in this particular case, obviously, how that happened. It could have been any one of a hundred different ways.

I think Oscar's point is that it's a cat-and-mouse game. You know, the crooks are working just as hard to keep stealing as we're working hard to stop them, you know, and that's why you have police.

(Laughter.)

MR. SCHRADER: It's no different in this case than it is in any other case of theft.

MS. BROADMAN: Thank you very much, Oscar.

Now we will move to the last part of our meeting, which is the Committee Reports, and we will start with Teresa, who will tell us what happened at the Consumer Credit Committee.

COMMITTEE REPORTS

MS. BRYCE: First, at our Committee meeting yesterday, we had a presentation on the evolution of the subprime credit card market. Rick Fisher from Morrison & Forrester joined us for the first half hour to talk about that, and basically what he said was that it was very difficult to see any type of bright line any more, that maybe 15 years ago, you could see a bright line between the subprime market and the prime market, but now it's really sort of a spectrum of cards and programs.

In addition, when we talked about problematic marketing practices and so forth, he indicated that he had seen those both in the prime market and the subprime market, and that there was nothing that seemed to be just in the subprime market, if you will, to be addressed.

So generally, the Committee thought that the current rules for credit cards are probably adequate, but the market should be studied to ensure that current rules continue to be adequate as the market continues to develop on subprime credit cards.

We also had a discussion of whether a new TILA disclosure form should be adopted for variable-rate closed-end loans and for home-equity lines of credit. The information on a HELOC form would probably be similar to information currently in the Schumer box.

Elizabeth provided a couple of suggested forms that we started looking at and the Committee decided to revisit the forms at the next meeting in order to give members an opportunity to analyze the issues more fully.

The next topic was whether there should be different disclosure requirements on online periodic statements. The concern was that the format would vary based on how statements are accessed. For instance, if someone decides that they're going to access their statements using a PDA, that obviously that would look very different than it would on a normal computer screen.

The general view was that if the formatting is set up to have appropriate fonts and format for a normal computer screen, that that should be acceptable. There are too many other issues -- I think at the end of the day, the Committee thought there were too many other issues of more consequence the Federal Reserve should spend its attention on than that.

The last topic was a review of the differences in the rules related to the use of convenience checks in connection with credit card accounts. There was particular focus on the consumer's right to assert claims and defenses. There was some view that the rights should be consistent; nevertheless, there is a particular challenge when convenience checks are issued or

written by the customer to people who are not merchants within the credit card, so if someone has a Visa, for instance, and they get a convenience check and they write it to one of us who is not a merchant, the structure for going back and asserting claims is a different situation than what you would have. So as a result, the Committee decided that this issue also needed further exploration at the next meeting.

We again did not have adequate time to discuss telephone cramming and whether it should be subject to truth in lending, and so we agreed that that will be high on the agenda at the next meeting.

Thank you.

MS. BROADMAN: Thank you, Teresa. And now we will go to Earl, who will talk to us about community affairs and housing.

MR. JAROLIMEK: Thank you, Dorothy.

The other subject we talked about in addition to financial literacy yesterday was new markets tax credits. Our own Buzz Roberts, who is the author of a piece and was our in-house authority on it, gave us some information about it. We were able to ask him some questions about it.

In very summary form, it's a new tax credit law that was enacted last December which will make $15 billion available by 2007. Briefly, new markets tax credits may be used to help finance economic development projects in low and moderate income neighborhoods.

So one of the things that we talked about was what role the Fed can play with respect to this new opportunity, and it involved some discussion about promotion, which I believe has already been the case with the Fed, and possible credit under CRA to help clarify just exactly what credit it will have for an institution participating in this program given its so new.

We talked about some subjects for the next meeting, and basic banking service for low-income individuals was brought up as a topic.

Some of the things we talked about is to get some feel for what works, possibly inviting some speakers in to tell us about some programs that they've had experience with, and review existing products to see how they might apply, and try to determine, you know, just what causes the unbanked segment of society and how basic financial products may play a part.

The other subject that we plan to talk about is to go a little more in depth on the subprime market to try to determine what has really been happening with that market. You know,

there has been a lot of action on predatory lending, the HOPA enactment, other things. How has this impacted the subprime market? We hope to bring up some discussion about that in October.

MS. BROADMAN: Yes.

MR. CHEADLE: May I say also that the Committee chair, Jeremy Novak, was not able to be here, and Earl -- and this is no surprise to us -- but I wanted to recognize that, as vice chair, he did a very admirable job.

MR. JAROLIMEK: Thank you, Robert. A $20 bill is secure with you.

(Laughter.)

MS. BROADMAN: Thank you, Earl.

And now Manny will talk to us about compliance in community reinvestment.

MR. CASANOVA: Thank you, Dorothy.

Just a brief recap. In our Committee, again, we discussed the evaluation criteria of a bank's community development activities, the performance context and examiner training. As far as topics for our next meeting, we want to continue -- it was a consensus we need to continue the discussion on enhancing examiner training and maybe banker training and maybe get some workshops put together and maybe have some more one-on-one sessions between regulators and bankers.

We also will be talking about the service test, perhaps further defining what constitutes community development services. That was talked about. And then I guess finally we will also revisit or review the definition of community, look at the assessment area in view of all the technology advances, and then if the proposed rule is out before we meet, we will certainly put that on the agenda.

Thank you.

MS. BROADMAN: Thank you, Manny.

And Russ, deposit and delivery services.

MR. SCHRADER: Thanks, Dorothy.

We discussed three topics. First, the USA Patriot Act, we had a briefing on where the treasury is and certain of its proposed rules; second, we had a discussion on privacy, the points of which we replicated and I think enhanced for you this morning; and third, we had a discussion on Regulation E, in particular stored value cards and the market developments that have occurred since the Board's proposal some years ago.

At our next meeting, we will continue consideration of these three topics and get to a fourth, identity theft, and building upon the presentation that Oscar made for us today.

MS. BROADMAN: All right. Thank you, Russ.

I believe we've come to the end of our meeting. I want to thank all of you for your great participation, and especially want to thank Governors Olson, Bies and Gramlich for your participation. It's very helpful to keeping us on track and ensuring that we're addressing the issues that the Fed is facing, so thank you again for your participation.

We are now adjourned and we will move to lunch for the Committee members in Dining Room L, which is just down the hall and to the left.

Thank you.

(Whereupon, at 12:50 p.m., the meeting adjourned.)