TRANSCRIPT OF THE FEDERAL RESERVE SYSTEM
CONSUMER ADVISORY COUNCIL
THURSDAY, JUNE 18, 2009

The Consumer Advisory Council met in Dining Room E in the Martin Building at 20th and C Streets, N.W., Washington, D.C., at 9:00 a.m., Edna Sawady, Chair, presiding.

Members present:
Edna Sawady, Chair
Michael Calhoun, Vice Chair
Paula Bryant-Ellis
Alan Cameron
Patricia Garcia Duarte
Jason Engel
Kathleen Engel
Joseph Falk
Betsy Flynn
Louise Gissendaner
Ira Goldstein
Greta Harris
Patricia Hasson
Thomas James
Kirsten Keefe
Lorenzo Littles
Larry Litton, Jr.
Saurabh Narain
Andy Navarrete
Jim Park
Kevin Rhein
Shanna Smith
Cooke Sunoo
Jennifer Tescher
Stergios "Terry" Theologides
Mary Tingerthal
Linda Tinney

Others present:
Benjamin Bernanke, Chairman, Board of Governors
Elizabeth Duke, Member, Board of Governors
Sandra Braunstein, Director, Division of Consumer and Community Affairs

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(9:11 a.m.)

Ms. SAWADY: Good morning, everyone. Nice to have everyone here. Before we begin, I'd like to take just a minute to acknowledge the Governors here with us and thank them for their ongoing support of the Council: Chairman Bernanke and Governor Betsy Duke.

And apologies for the late start. We had some security issues, but I understand they're all resolved now.

The first item on the agenda is the Credit CARD Act of 2009. On May 22nd, President Obama signed the Credit Card Accountability Responsibility and Disclosure Act of 2009. I'm amazed that these acronyms actually mean something in this Act. That's nice.

The Act amends the Truth in Lending Act, addressing some of the same practices as the Board's final credit card rules that were issued in December of 2008. However, the Credit CARD Act also addresses matters related to credit cards that are not covered by the previous Board rulemaking. The Act also amends the Electronic Fund Transfer Act through certain provisions related to gift cards.

Yesterday, members of the Consumer Credit Committee and the Depository and Delivery Systems Committee discussed issues related to credit card provisions and to gift card provisions, respectively.

At this point, I'd like to turn the discussion over to the committee chairs, Tom James and Kevin Rhein. Tom or Kevin, who is starting?

MR. JAMES: Sure, I'll start. Yesterday, we had a very dynamic discussion on, amazingly enough, credit cards. What I'm going to do -- I'm going to ask Kevin, who's co-chairing this with me, to kick off.

There are three areas that we'd like to cover, and we're kind of pushed for time today. I think we're contracting or condensing the schedule a little, and we're probably talking something in the area of fifteen minutes on underwriting standards, reevaluation of rate increases, and -- something we ran out of time for yesterday, so this will be a brand-new discussion -- on penalty fees.

But, Kevin, can you address --

MR. RHEIN: Sure. Our conversation yesterday within the Act and what the Fed's being asked to do is try to define how should you determine somebody's ability to repay when you're either granting credit or providing an increase in credit. One of the things that the industry was certainly advancing was flexibility and to write those regulations as broad as possible and to not get into a very specific enumeration around you must do X, Y, or Z.

There was discussion around the fact that we're not taking credit cards and trying to underwrite them like they're mortgage loans. That would just be absolutely impossible in terms of getting W-2s or tax returns or having to get pay stubs all the time.

And a lot the discussion really went into the predictability of credit scores and also some of the other scoring mechanisms that banks have and other issuers have using proprietary data, which led to some of the flexibility discussion. The factors that we might have looked at before -- things change over time, and no matter what the Fed might enumerate as acceptable things to look at, it's very dynamic.

So, for example, years ago we really didn't have this negative ARMs, negative option ARMs types of things, and that is something that became a pretty good predictor of risk and somebody's ability to repay because their mortgage rate should go up.

There was a fascinating discussion and presentation by Experian using some of the information from the VantageScore as to how credit scores are derived. I think the group at large learned a fair amount about that process, understood the statistical reliability behind those credit scores, understood the relative ranking, how it differentiates risk and that within that, that really is an indicator of ability to pay and that's a lot of what the industry is based around.

So our encouragement is to be as flexible as possible and allow a lot of things like credit scoring, which could also include internal and external information to be a factor of how you determine whether somebody has the ability to repay.

MR. JAMES: On ability to repay, this has been an enormously contentious issue certainly in the states with respect to many of the states, many HOEPA laws and the requirement of ability to repay that's been put into many of the state statutes. It's a concept, I think, that's proved pretty elusive in definition, certainly.

I was wondering if, Mike, you could help us a little on that.

MR. CALHOUN: Sure. Maybe I can also segue some into the penalty pricing, if that's okay, because I think there are some connections there and go back to –

It was quite interesting and I think everyone was quite impressed with the presentation on credit scoring. I think one of the notable things was the efforts they went to to validate the predictability of the scoring, and one of the things was they looked for as a validating point that there was a continuous function with a smooth curve. That there weren't cliffs or bumpiness, I think, as they described it.

And I think one of the concerns about the credit card pricing and one of the purposes of the legislation was that in contrast to that smooth predictability curve, the pricing model in the industry was quite bumpy. It was a turn-it-on, turn-it-off default switch that you would get advantageous pricing, but then if you missed one payment or were late with one payment, you lost the advantage to that pricing and people would see a doubling, for example, in their interest rate based on one, you know, five-day late, much less thirty-, sixty-, ninety-day late. And that seems inconsistent with the underlying pricing-model predictability and a disconnect between the predictability of a thirty-day late or five-day late and true credit score risk-based pricing.

So, if I can go on with -- just quickly. I want to leave time for others. It seems like there are really two repricing issues. One is market-based. Have we seen a shift overall in cost of credit or riskiness of the market? And the other is individual-based. Has the individual engaged in behavior?

There are precedents for the type of methodology that we would suggest should be required. For example, under Reg B, it requires for credit scoring that there be this type of documentation that has led to the industry standards of all the validation that is quite extensive on credit-scoring models.

The bill also calls -- and we echo the call -- for data gathering, just to monitor. Numbers matter. This is a place where there's a lot of rich data that should be gathered.

And to go to the purpose of the penalty pricing -- or if you want me to stop, if you want to go on to that with other people first.

MR. JAMES: Well, I think I'd like you to kind of set that up if it's possible. I think it's very important that it be covered initially, and then we can open it up.

MR. CALHOUN: One of the most important authorities delegated to the Board is the reasonableness standard for the penalty pricing and, again, we would suggest that it should be consistent with the extensive industry research about predictability of credit scores and that there should be a match between the penalty pricing.

In the days before the Smiley decision when the states imposed limits on credit cards, the benchmark when I went to law school in the early '70s was that penalties were not allowed by law. They were against public policy. That you had to prove that any so-called penalty was reasonably related to the cost incurred by the default in the contract. That we did not, as a matter of public policy and common law, allow a private party to impose unlimited penalties for contract breach. That was considered economically inefficient. That there should be instead a reasonable relationship between the cost to the party who suffered the default and the cost that was imposed on the defaulting party, and we would encourage that standard to be reestablished.

In our conversations with people in the industry, they have expressed dismay at the level of disconnect. We saw late fees go from $15 in a course of ten years to $39, and it suggests that maybe there wasn't a connection -- that they were revenue centers not tied to cost there.

So let me stop there. I would like to make some comments later. I want to respect other people's --

MR. JAMES: Sure. Jason.

MR. ENGEL: Yes, if I can add a few words.

Presenting on scoring is always fraught. It's a very complex subject and there's a lot of things -- a lot of variables.

To one comment Mike made, I mean I want to be careful in what we did yesterday because we did attempt to present some information on where scores are going in a changing risk environment and just pointing out that we're seeing increased risk across all score levels. I think it's just a point to keep in mind in terms of -- especially important for policy-setting and overall risk -- that a given score isn't correlated to a given default rate. Those default rates shift as the economy shifts, and we've obviously seen pretty profound changes.

Mike, your point that there were smooth lines in what we presented yesterday is right. We were showing that we were still able to rank-order risk within generic risk models like VantageScore and FICO and others in this environment, so that a higher score was a better score than a lower score, and that's important for users to know.

But, keep in mind that when we do that we do, you know, things with logarithms and that sort of thing to smooth out that line for comparison purposes. The risk changes between high scores where you see very low risk and low scores where you see very, very high risk are pretty profound. Those are big swoopy curves, if you will, not flat lines. My technical term.

So the pricing around that I think is appropriate -- and Kevin and others can speak more to that -- in that there really is profoundly higher risk at lower ends of the scale and very little risk in terms of default rate at the higher ends of the scale.

All interesting work, and I'd be remiss if I didn't mention that what we borrowed was a lot from an upcoming white paper from VantageScore. I'd be happy to get that to the Council and the staff and the Board once that's released, which will be in the next day or two. Examining a lot of these environmental factors, which I think may be far afield from the credit card bill and the use of scores and underwriting.

I think what we did is validate that the scores generally, generic scores are appropriately gauging risk, rank-ordering risk. The users of those scores are aware that there’s shifting risk within a given score's scale and that there are techniques that are used, particularly in credit cards, that are appropriate to mitigate those risks and use credit scores.

If you put it to me, you know, should credit scores be the only underwriting, I'd say it depends.

Certainly not in mortgages, I think has been pointed out. To the extent we saw that because of regulatory guidelines or statements in servicing guidelines from Fannie and Freddie that X score was good enough and everybody who had X score should get a loan. It had a bad effect, and we need to underwrite better in mortgage lending in particular.

If the question is credit lending and is a credit score on a credit report rich enough to do the underwriting that's required under the CARD Act, I view that as open. I think it can appropriately be done in an unsecured, open-ended line of credit, as has been done with both use of generic scores and custom scores that the issuers use.

Kevin, I think that was your point, your viewpoint on that, and you certainly can validate that.

MR. RHEIN: What we talked a little bit about yesterday was the scores that are produced through Vantage, through FICO, stuff like that, looking at credit bureau attributes. There's a lot of internal information that many times credit card issuers have based on bank relationships, deposit levels, number of years with the institution. There are many internally derived behavioral scores that follow an identical methodology to what happens when you use external information like the VantageScore.

And so, again, the whole point here was to try to get at how do you verify ability to repay in the granting of credit or increase. The point we were trying to get across is you don't have to have pay stubs. You don't have to have W-2s. There are many other factors statistically derived that give us the ability to understand probability of default, which by definition is "I have the ability to pay." That's part of the whole "I have the ability to pay."

MR. NAVARRETE: Yes, Tom, if I could just sort of build on that concept a little bit. I think it's important to understand a point Kevin was making, but perhaps to emphasize it a little bit more intensely.

The differences between mortgage products and credit cards -- credit cards, of course, are unsecured loans. There is no collateral underlying the loan that can be extracted for any degree of value. So when we talk about the ability to repay in the mortgage context, what we're typically trying to avert in terms of a consumer harm is an underwriter deciding that the value of the collateral is perhaps the real reason for underwriting the loan because there's an opportunity to foreclose, or in the context of even an auto loan where there's an opportunity to repossess the vehicle.

Obviously, with an unsecured loan, there is no collateral and no ability to seize assets, and therefore this concept of the ability to repay or the likelihood of repayment, which is precisely what the credit score is actually seeking to capture or to predict, really is the core of how we underwrite the product. It is the real critical measure to evaluate in the context of how we underwrite these loans.

As a result of that, I think we would advise the Board to perhaps not put in prescriptive rules trying to codify some of those concepts, but rather to just sort of underscore the importance of that measure in underwriting.

In terms of some of the points that Mike raised about repricing and unrepricing and the requirements in the context of either market-based repricing or penalty-based repricing to consider other factors and determine whether or not that merits a rate decrease at some point in the future, I think the statute does separate the concepts very clearly. There are separate provisions relating to market-based or economic conditions-type repricing, which is typically incremental, versus penalty-based repricing, which can, as Mike said, take a rate from a low purchase rate to an extremely high penalty rate virtually overnight.

There's a provision in the statute that allows for unrepricing or taking somebody back from a penalty rate back to their purchase rate for six months of good behavior. That's an automatic requirement, and so I think that that's an area that is largely taken care of by that provision.

Then there is a separate consideration of reevaluation every six months for any market-based repricing. We would again advise the Board not to be prescriptive, but rather to lay out criteria for underwriters to consider when they're making those decisions.

MR. JAMES: Kathleen, on underwriting standards, you had some issues.

MS. ENGEL: I guess my concern was how to balance the clear requirement that these methodologies be subject to review against the fact that these methodologies are going to be proprietary. That has to be something I think that the Fed needs to be conscious of because they really -- I understand why people in industry would like there to be a kind of soft regulation here that doesn't explicitly state what the appropriate methodologies are, and I think that those are valid arguments.

But if it's going to be a soft regulation, that means that then they have to be willing to subject those methodologies to scrutiny and that's, I think, a challenge from the Fed's perspective because of the proprietary information.

MR. JAMES: John's not here, unfortunately, but he did express concerns in terms of underpriced portfolios and the state of the industry right now, the deadlines that are approaching. I'm hoping that you can help us with that a little bit, Kevin.

MR. RHEIN: Yes, John had talked yesterday-- this is John Carey from Citibank. He could not be with us today -- there was a death of a close friend and he had to leave.

He was talking about the change in the regulations such that there's no more retroactive repricing on balances. One of the concerns that the industry has and it relates to this -- if you've repriced up, then every six months you have to take a look at accounts and determine if you reprice down.

There will be reluctance to want to go down because you can't really go back up. What we've lost in many ways is an important risk-based safety-and-soundness tool. So, again, if you get at how are you going to determine the criteria for dropping rates, we would just try to encourage the Fed to try to understand the difficulty of raising rates and what you can raise rates on, and all of that has to be factored into the overall equation. Because once it goes down, it's going to be very -- you can't go up on anything retroactive. You can only go up on something prospective. I think it's just something that we've lost as a tool.

And, Andy, I don't know if you want to elaborate on that a little bit more.

MR. NAVARRETE: Yes, I think the Board did a very good job in its supplementary information surrounding the issuance of the original rule, recognizing that taking away some of these back-end underwriting tools. That is, you make decisions, the best decision you're capable of making in the front end when you're underwriting. The old regime of credit card management allowed you some back-end tools such as repricing to make up for elements where you may have gotten that decision wrong.

What I think the Board did a very good job of was underscoring that taking away some of those back-end tools would necessarily raise pricing on the front end. Meaning that, without the ability to sort of make some of these adjustments on the back end, you would then have to underwrite to a higher standard on the front end. What the Board recognized and articulated was that pricing across the board for consumers was likely to go up.

With the legislation, obviously, we have a far more restrictive regime than even the Fed adopted, so I would think that same dynamic would be present here. What you will see over the course of time is adjustments to existing portfolios to sort of accommodate a new set of standards and requirements and a new paradigm in the credit card industry.

So when we are talking about sort of unrepricing, I think as a baseline we have to understand that the dynamics that existed pre-legislation versus post-legislation are markedly different, and, therefore, there is a sort of foundational element there that's going to have to put into consideration.

MR. JAMES: Patricia.

MS. HASSON: Okay. I am going to try and say this much more eloquently than I did yesterday.

While I understand what they're -- the whole scoring methodology and ability to pay, there is a factor in ability to pay. Scoring looks at past performance to predict future performance. Debt-to-income says whether or not you can truly afford it. When you look at it individually and you're adding a $10,000 line or a $15,000 line, that may, in your portfolio, look okay.

I tend to see the clients who got ten $10,000 lines. You know, somebody who has $24,000 a year who comes in with $40,000 of credit card debt. And the staff sits there and says, how did they get that? It's because each individual creditor is looking at it on their own portfolio.

And ability to pay is saying, if you were to use that full line of credit, if you were to use that $40,000 in lines, that's an $800 minimum payment on $24,000 a year. Can't afford it.

Now, I get the big picture, and I get that credit lines may need to be overall reduced because if you do it to a tough standard -- and I'm not saying that you have to say that this person has full use of those lines. But there's got to be some factor of, if all of those lines were in use, how would you evaluate this borrower? Because if somebody came to any one of those credit card companies on $24,000 a year -- even if they had a great credit score -- and wanted to get a $40,000 line, I don't think they would get it on unsecured credit.

My second a-ha moment actually just happened, which I have to comment on. It kind of seems odd to me that we underwrite mortgage loans where we do have collateral so tightly, and loans where we're giving money unsecured, we're saying well, we shouldn't have to verify those things.

I'm not saying we have to go to extremes. Please don't jump down my throat. But I just think it kind of seems odd to me that you would be looser with money that has no collateral than with, you know, those entities where you have to approve things like auto loans, in some cases, mortgages, where they have collateral.

MR. JAMES: Kathleen.

MS. ENGEL: I think I understand, Patty, what you were saying yesterday now, and I think the point is -- the larger point is that the concern is that we don't want the methodology that the credit-scoring companies use to drive the decision how to regulate this affordability standard. Because what Patty is saying is, what the analysis really should be is what's your full potential indebtedness and could you afford to pay if you extended out all the way.

As I understand some of the comments in response to that yesterday, they were well, that's already captured in the FICO score or the VantageScore because you get credit if you don't use your full line. Right?

Well, if you're not using -- instead of having part of the credit score be what percent of your available credit do you use as a factor, maybe it should be, are you late on your payments? Because it's creating this tail-wagging-the-dog situation in talking about these regulations.

If we didn't have this problem in the credit scoring, then it would be completely reasonable to use Patty's affordability standard, and all that would happen is that people would get shorter lines.

MR. JAMES: Kevin.

MR. RHEIN: I guess, a couple of things. What I hope we would have gotten out of yesterday's conversation is anecdotal stories versus statistical proof. What VantageScore, FICO, what all these different scores basically show is things like the utilization level is a very predictable element to the credit score, which will rank-order the probability of default.

Scores are not static. We talked yesterday about how credit underwriters are constantly getting refreshes of score. We have trigger events, so that if somebody opens up a new card that often is a trigger that existing creditors are notified. There are changes in scores as a result of activity -- everything from late fees, over-limit fees, utilization changes, new accounts getting opened. All those things affect credit scores, and that's what drives our decisions around granting new credit, taking down credit lines, whether an account should be risk-based repriced. All those things are statistically proven based on millions and millions of records.

I get the anecdotal, and I get how it just fundamentally doesn't make sense. But I would tell you that it works, and it works the vast majority of the time. And so we do understand that person that might have ten $10,000 cards, which is an extreme case. I understand that's what you see. That's what you do for a living -- you're in credit counseling. You're going to see the people that are in those extremes.

But the whole point of credit scores is it does accurately predict risk. There are other methodologies similar to that used for internal information -- overdrafts, average deposit levels, number of relationships somebody has with an institution -- and it's all statistically derived.

MR. NAVARRETE: I think it might help the conversation to try to draw these two concepts together. Because in some respects, we're talking about credit scores being over here and then behavioral elements being over here. The fact is that they're inextricably linked. I mean, what the credit score does is actually quantify the behavioral elements.

So, why is utilization rate such an important component of a credit score? Why is total open to buy such an important element of the credit score? Because these are behaviors that predict risk. In that example, if somebody has ten $10,000 lines, their credit score is going to go down as a result of that, just because the level of exposure has gone up rather precipitously. If they start to draw down on those lines, and so their utilization rate goes up, their credit score will decline at the same rate that that utilization rate is going up.

So all of these elements are embedded in the credit score. Now we will look at both the separate behavioral elements. We'll look at our own experience with the customer, be it in credit cards or other lending products. We'll look at the credit bureaus to see whether or not they've made on-time payments on their mortgages, on their auto loans, to utilities, to any other entity that might report.

And so all of these things are linked together. But the credit score is not separate and apart from that. The credit score is a quantification of those very concepts.

MS. HASSON: Two points. First, I think, Kevin, when you're talking about overdrafts and the other things that you look at, that's within your own portfolio and that's assuming -- I think Wells has a pretty large portfolio, and I don't know what percent are existing clients. So I think that's one factor, and people who don't have perhaps those accounts might not have that information, and that is something I think that the Board has to think about.

And the second is, while you may all be doing it well in your shop and you may be reducing lines, others may not. So that when you give that individual that overall ability to draw down on it, that's what results. That's what we're seeing. We see not only credit counseling but bankruptcy clients, and it's people who had that availability who drove it up for whatever reasons, whether it was loss of a job. But that's the reality and if people -- many of them also just had limited income and used those lines.

I think if you looked at them holistically, which is what we do -- you know, we look at the whole picture. I think if you think about even mortgage defaults, redefaults on loan modifications, if you look at people holistically, it's really tough in this environment. There's a lot more to their picture than just your individual line.

And so while I appreciate that, I think that the entire financial picture of that individual in some way -- and I haven't defined that some way -- but it has to be looked at. You have to be, and your ability to pay, have to be considering that, not just the individual that you're going to cut the line, because others may not. So that's why the individuals may get there, and that's one, you know, anecdotal.

I mean, I didn't even use my really good one, Kevin. True story. True story. Nine hundred thousand dollars, two professors, in lines of credit. How do you get $900,000 in available lines of credit? This is how, because it's looked at individually. It's not looked at as the whole, and I think it just has to be considered at that level.

MR. JAMES: Yes, that's interesting. When you were speaking yesterday, you know, about the aggregate, in total, lines of credit on any single individual and the individual's exposure to enormous amounts of credit, there was kind of the problem we saw in the mortgage products, which were obviously structured to self-destruct or they had -- you know, they had very limited lifetimes. And there resides the thought that these were, it was really a game of Russian roulette and that each lender was handing the next lender the loaded or the -- you know, the pistol with one chamber loaded. Everybody was making money until one lender got knocked off. So that is, to me, a very significant problem.

I want to go and switch to the other side of the coin, really, which is the rules that have to go into place regarding penalties on the credit cards. There's some very interesting language in terms of rulemaking, I think, that the Fed's supposed to consider in talking about penalties. The considerations that are supposed to come into play are cost; deterrence, which sounds to me very behavioral; and then conduct, which sounds to me as kind of like credit scoring or something. So, I think --

MR. RHEIN: Well, Andy, you had some comments --

MR. JAMES: I'll go to Andy on that.

MR. RHEIN: You want to start with that? I know Mike had some other comments as well.

MR. NAVARRETE: Sure, again, this is probably an area where -- I think the Board was given two choices, really. One is to come up with a set of principles for what would determine reasonableness and proportionality in the cost of penalty fees, and then also potentially availing itself of a safe harbor, which would effectively be a fee cap that could be assigned.

I think our view is that the former route, which is a set of tangible criteria to consider in determining reasonableness and proportionality, is the more flexible and probably the more useful tool.

There are elements articulated in the rule such as the cost of the infraction, the conduct of the consumer, deterrence -- which we think is a very, very important concept -- and then there's a bit of a catch-all provision that I think allows the Board to articulate other criteria. We would certainly like to see portfolio-based economics enter the picture as well.

As I think most people know, much of credit card pricing is really determined on a portfolio basis rather than on an individual basis, and most risk is reflected that way. And what I mean by that is that you can always assert that in good times maybe five people in 100 may charge off. In more stressed times as we're facing now, that may double to ten people in 100 or one in ten.

If we were to be able to predict with 100 percent accuracy who that one individual is that goes bad, then we could obviously reprice everybody else at a much lower rate and reprice that one individual at a much higher rate or decide not to underwrite that individual at all. The problem is that we can't. We can only tell you one in ten will go bad. We can't tell you who it is and, therefore, some of the cost of risky behavior has to be spread across the entire portfolio.

Penalty fees serve to address that. You can't control, for example, when somebody will pay you and, therefore, a late fee has to be not only a measurement of the cost of the infraction on the individual basis, it has to be a cost of the infraction across the entire portfolio and then has to serve a deterrent effect to make sure that the person is incented to pay back in a timely way.

We would point out that because of the other provisions of the rule -- for example, no ability to reprice APR until somebody is sixty days delinquent -- at this point, we could face a situation where there is absolutely no consequence or no meaningful consequence to somebody going fifty-nine days late on a payment. So if a penalty fee, a late fee were only $5, for example, because that reflects the pure administrative cost of the infraction, what you could have is somebody consciously making a choice to delay their payment for fifty-nine days. They would pay $5 for that ability and that, I think, could present significant risk to the industry as a whole.

I'll make one last point and turn it over to others for comments. I think it's important to understand that none of the new rules, either under Reg AA or Z or under the new legislation, have actually gone into effect yet, and yet the industry, because of a doubling in loss rates from 5 percent to about 10 percent, that has wiped out profitability across the industry.

I think a year ago the discussion would have been about the obscene level of profits within the credit card industry. What you see now is that this is an extraordinarily risky product, and a lot of these tools to manage risk are being taken away. So I think it's important to preserve some elements of what's left over to insure that we can continue to lend at the levels that we have been lending historically.

MR. RHEIN: Mike.

MR. CALHOUN: Well, just to segue from the last comment, I think this is a great example of where consumer protections and safety and soundness actually overlap. I think there was a conclusion from Congress that the existing business model was not optimal in either respect. That the idea of bringing people in at low interest rates, which I think was openly described as the model, and then price them up from there with heavy penalty fees caught consumers unaware that it also wasn't the most sustainable credit market, particularly on a macro level. So I would argue that this is a great example where there's not tension but rather overlap in the goals of providing those consumer protections.

On the models, one of the important lessons that we had from the models yesterday was that there was an example given in the presentation that the model testing had shown in the context of the subprime mortgages that more than 20 percent of subprime borrowers for the portfolio that was being looked at were improperly put into the subprime category when they should have been in the prime category. And it was only, I think -- it was spurred in part by the validation requirements for the credit scoring models that were being used that forced that to be refined, which moved a substantial population into a more appropriate pricing level.

So I would suggest that having a rigorous validation requirement for the pricing standards and the penalty standards is important to encourage the market-based innovation. If you have that strong validation requirement, it allows a lot of freedom, but it puts that requirement -- I think everyone was quite impressed with the KS [Kolmogorov-Smirnov] statistics and everything that were essentially industry-developed standards for how you establish validation under Reg B for the scoring models. We would like to see those types of incentives created as well under this.

If I can just briefly comment about one of the specific penalty fees that is addressed in some detail -- but the Board has also been accorded some important discretion and regulatory responsibilities – are the over-the-limit fees. The structure there is a mandatory opt-in for all accounts, but the Board is required to come up with regulations about the type of disclosure, the manner of disclosure, and protections to make sure that consumers benefit from the statutory protections. For example, requiring same terms for accounts with and without over-the-limit fee protection so that it can't be gamed. For example, one thing that would be detrimental would be to have providers set artificially low credit limits for accounts without the over-the-limit fees, thus essentially tilting the scale to require people to sign up for the over-the-limit coverage.

And then, finally, it seems that there are very close parallels with the over-the-limit fees with another topic that we discussed at, I think, our last CAC meeting, and that is the overdraft protection for checks. You have virtually the same list of issues. Will it be opt-in or opt-out? Will it apply to existing accounts or only new accounts? Will you allow -- for example, there's a request to allow additional fees on loans, on checking accounts that don't have bounce protection. It would seem disconsonant to have very different rules, some of them already statutorily prescribed in the over-the-limit credit card arena, than you would come up with under your regulatory authority for the overdraft protection that you now have under consideration as well.

So, we would suggest that -- in fact, during our discussions, there was from industry the point raised that the credit card fear of having your card turned down was very similar to the fear of having your check or your debit purchase, in particular, not processed or accepted. So it would seem that those sets of rules should be very similar.

MR. RHEIN: Well, not surprising, Mike, just a couple of quick comments. I want to build off of what Andy said, and that is around the reasonableness of the fees. Again, going back to statistical modeling and predictability, we know that when customers are late or over-limit there's a higher probability of default. So I think it's important that the Fed, when they take a look at the reasonableness of the fees, you have to incorporate a higher loss rate. It's not just how much does it take to make the phone call and the staffing levels and all that sort of thing, but the fact that those fees are a clear indicator of risk and a higher probability of default. Somehow in this reasonableness factor, I think that has to be a very important thing. And again, the statistical modeling can show you that – that that does drive higher loss rates.

I do want to comment on the subprime mortgage category. What's important in understanding a subprime mortgage, in part, is it's a lot more than just a credit score. It is the debt-to-income, which is actually calculated, which is different than the unsecured credit. It is the loan-to-value. So I don't think in a mortgage situation you can exclusively look at a credit score and say that's the only driver of subprimes. I don't think the methodology to compare is appropriate in that particular case. It's one of multiple factors that drive whether it's a prime or a subprime category on the mortgage side. So, just want to clarify that.

And then one thing I am very concerned about on the credit card side, for example, and likewise on the overdraft that you brought up is -- think about the effective date. If it's opt-in, which it clearly is on credit card, and it may end up being opt-in on the overdraft or debit cards as well, on that date, if people haven't opted in and you have the natural behavioral issue of people don't respond to things, you will have a disproportionate number of people that have not accepted the opt-in. That day there will be millions of transactions across the debit and credit cards that will be denied at the point of sale.

So as you start to think about the timing of whether it be new accounts versus existing portfolios, I would just encourage the Fed to be thinking about the economic impact of what happens when all of a sudden all these people that have not opted in are suddenly denied on all these different cards. Maybe there's a way in the interpretation of these regulations that you think about some phasing in on new accounts versus existing portfolios.

MR. NAVARRETE: I just wanted to go back and just follow up quickly on one of Mike's points about over-limit. I had talked about this sort of dynamic of past-due earlier, but again, I think there's an opportunity here to make sure that we look at each one of the provisions of the Act and how they interact. In this instance, the fact that now there is an opt-in requirement for over-limit provides an extraordinary governor on the "reasonableness" of the price of the fee, because the customer now has to agree to pay that price and only will pay that fee if they agree to do so. So the need to put in very prescriptive rules or even a fee cap when the governor, you know, is actually the customer's choice would seem to be unnecessary. I think that's an important dynamic.

I'd also echo a point that Kevin made, which is about the speed of getting some clarity around some of these new requirements. We would hate to be in a position of on February 22nd of 2010 having to get everybody who wants to opt in to opt in, in order to avoid the significant sort of economic disruption that this will cause. So the sooner we can get some guidelines and some sort of safe-harbor-type provisions for how, mechanistically, we secure these opt-outs in advance of the rule would be extremely helpful, so that we can stretch out the implementation period.

MR. JAMES: Mike.

MR. CALHOUN: I think it would be useful to have data on the predictability of these penalty conduct, and I would suggest perhaps one approach for the Board would be to look at the levels that these fees were ten or fifteen years ago and ask the industry. It's one of the things that led to this legislation -- these fees have increased by more than 200 percent in the last decade. Has their predictability for default increased by 200 percent in the last decade? And what has been the data that has shown that the dramatic increase in the fees was due to a dramatic increase in the predictability of the conduct that triggers those fees?

MR. NAVARRETE: Two quick responses to that, Mike.

I mean, if you're going to look at the price of fees ten to fifteen years, I would also look at the availability of credit, the prevalence of credit cards ten to fifteen years ago as well. Obviously, it's gone up considerably. The other thing, and I know that GAO studied this, but also look at the average APR for purchase rate, which has gone down during that period of time.

So there are tradeoffs. When fees go up, typically APRs will go down because fees represent a different kind of risk-management tool. Also, fees are in part related to competitive dynamics within the industry, in the same way that free checking has increased the cost and prevalence of NSF fees. Zero-percent teasers are sort of the equivalent within the credit card industry, and the legislation and certainly the Fed's rule before the legislation does a lot to take the “0 percent for eighteen months” or some sort of irrational forms of competition out of the marketplace. So I think you will see some of those tradeoffs play off as well.

MR. JAMES: Okay. Well, we're down to -- oh.

MR. NARAIN: You know, when I was growing up in banking, several years back and I have gray hair to show that, we used to have unsecured lines of credit approved for corporate clients and individual clients, and there the ability to repay was a very significant criteria used in creating lines of credit. Over a period of time, those unsecured lines have actually moved to credit cards, and banks don't really do unsecured lending as much as what was done earlier. To your point, Andy, yes, credit card debt was not there because banks were giving unsecured debt at that point in time, which they have moved away from that in the form of direct lending.

So, I think a lot of the discussion really does lead to what Patty was saying, in terms of understanding the affordability and the likelihood of paying in several of these decisions. I'm truly sympathetic, you know, and truly understand the issues, Kevin, you're raising on this issue of, if you shackle people's hands, then the credit will go away. Maybe it is desirable for some of this credit to go away.

MS. SAWADY: Tom, I'd like to make a comment.

MR. JAMES: Okay. And we've got two more.

MS. SAWADY: Okay.

MR. JAMES: Kevin.

MR. RHEIN: No, go ahead.

MR. JAMES: Go ahead.

MS. SAWADY: Okay. Thanks. Well, we have been talking about credit scoring, which absolutely has a very significant role in approving or denying a credit card availability.

I just wanted to go now to the other extreme and talk a little bit about other aspects that may and will go into the proprietary decisions that the insurers are making -- specifically, the interpretation of what ability to pay means. My concern is that, since the wording is pretty general, that there may be some very restrictive interpretation -- like, the ability to pay means ability to pay the minimum balance -- and that can be, in my view, problematic.

We heard some numbers yesterday that with current minimum payment requirements, if somebody stops using a credit card line of, what was it, $5,000 or $7,000, it might take them seven years to repay it back.

So, just wanted to keep that in mind as we go from the macro level of looking more at the overall scoring models to more the micro day-to-day management and making sure that there may be some language there to guide the interpretation of what it means to have the ability to repay.

MR. JAMES: We're very close to -- oh. Kathleen and then Joe and then --

MS. ENGEL: I think that this question of validation keeps coming up in different forms -- the people talking about the importance of using the credit scores and having them validated for the purpose of the rate increases. I think, as I understand what Mike is saying, is that he wants the same rigor applied to the question of penalties. So when the Fed is thinking about the rules regarding penalties, hopefully the regulations will take into account empirical evidence of what is the actual cost to the creditor.

I understand Kevin's point about the increased risk. I assume that would be captured also potentially by a rate increase. We don't want to be captured by both, a penalty and a rate increase. We want to be concerned about duplication.

Also, what kind of evidence the industry has about the proper fee that will deter since that's a factor that the Fed needs to take into account. There needs to be some type of empirical testing of what's the sufficient fee to deter and also evidence of how effective penalties in the past have been at deterring. And then, of course, there's the issue of the conduct of the cardholder.

I think we want to hope that the Fed will impose the same rigor in the penalty regulations that the industry is arguing for in the affordability measures under the rate increases.

MR. JAMES: Joe.

MR. FALK: Andy, you commented before and I want to delve just one level deeper on the request -- you posited the possibility that delinquency or penalty interest could be analyzed by portfolio.

I interpreted that to mean that if I'm in one portfolio and Cooke is in a different portfolio, the aspects of my portfolio if they're not paying the other people in this credit card pool -- maybe it's securitized -- might be subject to different penalty provisions than the pool that Cooke might have gotten into because he got lucky and applied two months later, because it was in a different pool.

Is that what you were saying?

MR. NAVARRETE: Well, I mean certainly there's different APRs depending on different risk, and we also tier our penalty fees. It can depend on factors like balance. It can depend on factors like the overall credit line, depending on what the penalty fee is. Lower balances, lower credit lines will typically pay lower fees.

So, yes -- the answer is that the portfolio dynamics exist or whatever within certain segments. Some portfolios are quite small and some are quite large, depending on the risk characteristics. But everything is -- the whole premise behind risk-based repricing is that some people who are riskier pay more and some people who are less risky pay less.

I will tell you the legislation changes that dynamic, and I think it pushes more towards less risky people paying more, more risky people paying less or perhaps not getting access to credit. So, that balance is shifting as a result of the legislation, but some of those same dynamics, I think, will continue.

MR. FALK: Are you saying that my behavior will -- and my penalty provisions would be different because of what pool I'm in versus Cooke’s pool, or are you saying that my penalty provisions based upon my personal experience would dictate what my penalty provisions would be?

MR. NAVARRETE: It's a combination.

MR. FALK: Is it based upon pool analysis or individual consumer --

MR. NAVARRETE: Both. All we're asking the Fed to consider is basically allowing us to consider both dynamics. For example, your paying late twice in a twelve-month period, which is our penalty repricing policy, might increase your rate to a penalty rate. That is your individual behavior.

MR. FALK: Right.

MR. NAVARRETE: You may be paying more, for example, in terms of your APR because you're in a riskier pool than someone else. Our request is that we simply consider both factors because, you know, what we're talking about is the reasonableness of penalty fees and APRs.

I would again point out that, notwithstanding the fact that some people believe that currently penalty fees are unreasonable, they're not sufficient to cover losses when losses go up as much as they have. Otherwise, we would as an industry remain profitable, which we're not.

MR. FALK: So, in other words, my late fees could be determined by the luck of the draw of what pool I'm in and the characteristics of the other consumers in that pool rather than just my payment pattern?

MR. NAVARRETE: Yes.

MR. FALK: And --

MR. NAVARRETE: I wouldn't consider that luck.

MR. FALK: Well, it depends what pool I happen to land in.

MR. NAVARRETE: Obviously, there's some credit characteristics that put you in that pool in the first place.

MR. FALK: But if I happen to land in the wrong pool or I open my credit line in '08 versus '09, my penalty costs would change based upon other people's --

MR. NAVARRETE: Yes, similarly situated people.

MR. FALK: -- performance?

MR. NAVARRETE: Absolutely.

MR. FALK: And candidly, from my perspective, I have a problem with that because I should pay penalty interest or costs based upon my performance, not what somebody else is doing inside a similarly situated pool maybe because I just happen to get unlucky and get in a bad pool.

MR. NAVARRETE: Let me just try to separate the two concepts a little bit. The pricing of the penalty, should you engage in some individual behavior, would be determined on a portfolio basis. You know, similarly situated people sitting in the same pool.

Whether or not you actually incur the fee is entirely up to you. If the person next to you is paying late, that doesn't mean that you will pay a fee. Only your behavior can trigger a penalty fee or a penalty rate. So, that is entirely within your control.

MR. JAMES: All right. I wanted to take one minute and give the floor to Kevin just to touch on gift cards.

MR. RHEIN: Yes, it’s kind of awkward that it's under the CARD Act, but there's -- we actually covered this a little bit in the Depository Committee, and Luz is not with us today.

To summarize, we had a discussion yesterday around the gift card act and those provisions. And frankly, we're pretty confused about some of the things that the Fed is being asked to do around the definition of what products are covered here. I think that was one of the items that we discussed.

Where we started to come out is the distinction between a disposable gift card and a reloadable gift card, and yet there were some elements of reloadable that if it was somehow deemed to be a gift, a reward somehow, that that might start to fall under the regulations. We got into a lot of dialogue about that.

I think we came out generally with a comfort level that -- just draw a distinction between disposable and reloadable and that reloadable should not have these factors that Congress has put into this particular CARD Act legislation be included in that space. If anybody disagrees, by all means, pipe up.

Jennifer, you want to maybe --

MS. TESCHER: I don't want to disagree. I want to draw a slightly different distinction. I'm not convinced the Fed will actually have that flexibility, given the way the statute has been written, as much as I would like them to be able to have that flexibility.

I think the most important thing to get right is to reiterate what the law allows, which is that it exempts cards that are reloadable and not marketed as a gift card or gift certificate. It's really important, I think, to leave aside for another day what have become known in industry parlance as general purpose reloadable cards. They're not gift cards. These are cards that are highly functional, and that look and feel very much like a traditional checking account. They have significant promise for underserved consumers. It's a growing market. Those are very clearly, I think, based on the way the law was written, not a part of this regulation. I think that reiterating that and drawing a very clear distinction and a bright line there is incredibly important.

As much as you can draw other distinctions based on reloadability versus not, I think that would be helpful. Whether or not you have that flexibility is not clear.

MR. JAMES: Okay. Kevin. Oh, Mike. I'm sorry.

MR. CALHOUN: One last point on the gift cards. The legislation asks that the Board look at whether these exempted cards, which I think are specifically the ones you're talking about, which do have the potential to help be a bridge for the unbanked. People use them either as preloaded credit cards or as sort of electronic checking accounts. But the legislation does ask the Board to look at whether protections under Reg E and the Electronic Fund Transfer Act should apply to them, and we think at least substantial parts of those should apply to this growing important area of these prepaid reloadable cards.

MS. TESCHER: The concern from where I sit is not that we shouldn't have the Reg E conversation about general purpose reloadable cards. It's that I think it would be very confusing in part of this regulation to say general purpose reloadables are not included for these following things, but when we get to Reg E, it is included. I think that sends a very confusing signal.

So, that's why I put it, let's save it for another day. Not that we shouldn't contemplate Reg E, but that to do so in the context of this, I think sends a real mixed message.

MR. JAMES: Kevin.

MR. RHEIN: Yes, two other things that came up in the gift card, and folks should feel free to chime in. One was this issue date and the five-year expiration from the issue date. The mechanics of a lot of general purpose gift cards is they're pre-embossed with an expiration date, yet they might not be sold for X number of months later. And if the expiration date is contained in the mag stripe, which it typically is for authorization purposes, how do you define issue dates? How do you start to define expiration? So, there's some mechanical difficulties that I think the Fed's got to try to clarify as to when does the clock start. That certainly gets even more complicated with reloadable cards.

And then the other thing was the ability to charge fees on disposable cards -- this monthly service fee versus a lost card fee versus some other things. It implies there can only be one fee in the month. Well, what if somebody lost their card and there's an inactivity fee in the same month? Does that mean you can only charge one of those fees?

So, we thought there had to be some clarity around what does that mean around only one fee, and transactions fees should probably be separate from dormancy fees or service fee type of thing.

Obviously, anybody else care to chime in on that?

MS. SAWADY: I wonder, Kevin, if you can just elaborate for a second about the reloadable card and the difficulties with the expiration date. We had very specific scenarios of somebody's buying a card or reloading it two months before the end of the time and then all the mechanical problems that it creates.

MR. RHEIN: Yes, I was thinking about that a little bit more. I think on a reloadable it would be just like you have a regular debit card. You have expiration on debit cards. If it's reloadable, somebody's going to get a card reissued. I don't know that that is really as much of a problem even if they reload it, if it's an ongoing product, to Jennifer's point, like a regular checking account. Well, that's very similar to a debit card, so I don't think the expiration date's an issue in the reloadable. It clearly could be in the disposable.

Just to note, Jennifer Tescher and CFSI had a phenomenal presentation yesterday on reloadable prepaid cards, different segmentation work they've done, things like that, that I think the whole group really enjoyed seeing. It was very illustrative of how prepaid cards can be a step towards mainstream banking in general and the uses, the segmentation work that I just thought was great and if anybody else cares to chime in. But I think the team got a lot out of seeing that presentation overall. It was some very, very good quality work.

MR. JAMES: Okay. And I guess actually I just want to sound one note. As the chair, I wanted to hold back to the very end, but back to the credit cards and particularly back to the penalty fees.

I, like Mike, was academically trained in the law, and the penalty fees have traditionally always been the province of the sovereign. And to see them migrate into contract between individuals is a very disturbing trend for people trained the way I was trained.

And so, as a matter of policy, I think the penalty fees should never evolve into a profit center. They belong to the sovereign. They are for guiding conduct along policy guidelines. I just want to instill the thought that there should be extreme jealousy here with respect to allowing private individuals to allocate that kind of relationship among themselves.

MS. SAWADY: Thank you. Well, it was a really great discussion and really timely.

So, now we are onto the Community Reinvestment Act, which was enacted in 1977, and it has fostered access to financial services for low- and moderate-income communities across the country. Yet, since the passage of CRA, the financial landscape has changed dramatically, and now there's a general consensus about the need to reexamine this important regulation in the context of financial modernization.

Yesterday, members discussed the future of CRA including possible changes in light of developments in the financial services industry, and I get the feeling that it is just the first round of discussion. We'll probably get back into it in future meetings.

I'd like to turn it over to Ira Goldstein to lead the discussion.

MR. GOLDSTEIN: Good morning.

As Edna said, it was the first of what we hope will be a number of discussions taking place over the next several months where what we're trying to do is to both figure out what we think are the critical issues that ought to be addressed in any changes to the Community Reinvestment Act and really just get some general notion about what the parameters of those issues are. And, to the extent that we can come to some consensus about what the recommendations ought to be, that's where we would like to end up. I guess today's discussion is really a glimpse into those prior discussions and maybe sort of looking forward as to what those things will be.

As Edna also said, you know, the Community Reinvestment Act is now thirty-plus years old, and it was born in a very different time. I think what we're going to try and do is to understand what that time is and what the time is now and really try and build into whatever kinds of issue enlightenment we come to that is sensitive to the history and evolution of the issues that brought forth the Community Reinvestment Act.

Having said that, the first of the issues I think that we would like to cover in some depth would be the extension of CRA or the parameters of CRA beyond that first set of depositories that was initially contemplated with the passage of the Community Reinvestment Act. Again, thinking about the notion of receiving deposits from a place and making sure that those deposits go back to that place and not exported to other areas and other populations.

There were a number of people around the table who had a set of different points of view, and I think that Saurabh, Alan, Patricia, each of you had a different point of view, in some ways complementary, in some ways not. I thought maybe we could begin with Saurabh.

MR. NARAIN: Thank you, Ira.

First and foremost, I want to thank the Governors and Chairman for support for the CDFI sector yesterday in your speech. That was really well received by the industry.

CRA as an act has worked over the last thirty to thirty-five years in driving significant amounts of investments and loans into the low-income communities around the country, and we want to find ways of strengthening that and expanding the focus of regulations to continue to bring in services.

The question that's been raised is, should we be expanding and to whom. There’s been a fair amount of discussion on this subject in the industry, and expansion should really be thought about in three different forms, according to me.

One is the inclusion of non-bank, non-depository affiliates of large institutions. So, under a bank holding company, if a bank has mortgage subsidiary, it's not currently covered, or it is the choice of the institution to cover it under CRA or not, which is very counterintuitive for the industry. If the non-banking mortgage subsidiary is doing stuff which it does not want to be covered by CRA, well, so be it. They would choose not to include it, and so on.

The second part in relation to expansion is expansion to other financial services providers -- credit unions, insurance companies, and possibly other financial services providers. And it starts getting more and more controversial as we go down the line.

But the third and probably more important aspect of expansion is expansion beyond lending. In this time and age, it's not only lending, and this discussion about more lending being very good is a problem. Not everybody wants to borrow or necessarily should be borrowing. Provision of financial services, savings accounts, checking accounts, provision of insurance capabilities for health-related insurance or property and casualty insurance, and provision of relevant services is very, very critical for underserved communities.

So, when we think about expansion, we think about expansion on three counts: inclusion of subsidiaries, non-depository subsidiaries under the bank holding company; inclusion of other forms of financial services providers; and inclusion of other forms of financial services in the industry.

MR. GOLDSTEIN: Alan, you had a position yesterday, if you could share it with us.

MR. CAMERON: Thanks, Ira.

We should start from the point that my industry, credit unions, are not subject to CRA, and so we do speak as outsiders. But it seems to me that over time the goal and focus of CRA have kind of morphed into one of capital production for community development. If, in fact, that is the goal of CRA -- and it's certainly a laudable goal, it's a goal that I can support -- I think we need to make sure that we balance the capability to be able to support that goal by those institutions that you want to add with the capabilities of that institution. If there's not a match with the ability, either because of legal authorities or regulatory authorities or limitations in those authorities, then it's not appropriate to extend CRA requirements to those institutions.

Additionally, these institutions for the large part are very small ones and, therefore, have lesser recordkeeping capabilities. The burden of the Community Reinvestment Act on financial institutions, on banks, has been significant, and I think we need to keep that in mind when we consider extending that so that we don't essentially throw out the baby with the bath water. What we want to do is ensure that we continue to help communities and not to hurt the very institutions that we seek to have help them.

MR. GOLDSTEIN: Patricia.

MS. DUARTE: I have the privilege of having been on both sides, representing an institution on community development implementing the CRA and having been in the nonprofit sector, and I have seen the benefits on both sides. In a perfect world, we wouldn't need CRA, but it is not a perfect world and CRA has done wonderful things. It has been a little bit painful for some institutions, but the benefits to the communities have been tremendous.

The needs of the communities differ throughout the nation, and they really should be evaluated. CRA heavily weighs the lending part, and I agree with Saurabh's comments. Not everybody needs loans, but access to financial products.

Nonprofit organizations have been fortunate to bring people from financial institutions to their boards, have brought in more volunteers to teach financial fitness, subject-matter experts in those topics. But for CRA, we wouldn't be able to bring in the volunteers needed for the service test. And under the investments, the philanthropic support that a lot of organizations benefit from CRA just wouldn't be there.

I think CRA's been great. CRA is a little bit outdated, so it needs to be modernized. But it should also be expansive and include others that would also benefit from the CRA movement.

MR. GOLDSTEIN: Kevin.

MR. RHEIN: I guess one thing I'd like to caution the Board on as you think about this is many people have said CRA has been very effective. And if you go back to its core idea, it was that banks shouldn't be able to take deposits out of a community without providing services, at its core. I think the more laser-focused you are on what you're trying to accomplish, I think you get great progress that's occurred over the last 30 years.

So, as you start to get into non-depository institutions and how are they servicing the community need, I think there's a real risk that you can start to diffuse what it was fundamentally set up to do, which was, if you're going to take deposits from a marketplace, you need to be providing services. To your point, Patricia, services can be many things other than loans. It can be financial literacy. It can be other things that go along with that.

So, when you try to take something and have it solve everything, you can get a very diffuse outcome as a result of that.

MR. CALHOUN: To follow up on Kevin's comments, I do think that the underlying rationale for CRA was this quid pro quo that institutions were receiving substantial benefits, for example, from deposit insurance and the like, and also that this is an appropriate time -- and, quite frankly, a long overdue time -- to reevaluate the CRA model.

But I think that quid pro quo has expanded. The actions of this Federal Reserve to stabilize the economy have reached far beyond just deposit insurance. There are many other types of institutions who have benefited tremendously from those interventions and with those protections. We don't want to necessarily be locked into all of them indefinitely, but with those protections, it does seem there is a reasonable request to further community development and to further the CRA goals.

And then an additional comment -- as mentioned before, I think there is a lot of agreement that it needs to look at more than just quantity of credit. Although, as Governor Duke said, I think, this morning at breakfast, quantity of credit is going to once again come to the front and shouldn't be regarded as solved, particularly in this sector.

But there are other important things to look at -- the quality of credit and the sustainability factors. Certainly, there should be credit for preserving home loans in this current environment -- modifications and the like, not just refinances. But, overall, there needs to be, I think, this focus on the terms of credit and the sustainability of that credit.

MS. GISSENDANER: Yes, I agree, Mike. And I think that the other really important piece here is that we are looking at something that we've not seen, and this is the economic environment and the impact that we've seen on, let's just say, the neighborhoods that we've supported through economic development, the economic development industry, and also certainly the banks and the change in that. I personally do feel in looking at the environment that we're in that it's going to take more than just the financial institutions to really reinvigorate the neighborhoods and to bring things back. Because I think as you go around the table, and we've done that before, the impact on many of the neighborhoods has just been tremendous.

A lot of the work that we have been able to achieve and accomplish over the past 30 years unfortunately quickly disintegrated. We can't lose track of that. I think that with the financial industry having their own woes, it cannot be expected that they'll be able to garner everything that's needed, I think personally, to bring these neighborhoods back.

Obviously, there needs to be more innovation, as well, around products and services that folks are going to need in the future, so the modernization of it is extremely important. And while we're modernizing it, we might as well think out of the box here to determine the vast majority of other institutions that can support this effort.

MR. GOLDSTEIN: I think it was Jennifer -- excuse me. Greta. Then Jennifer.

MS. HARRIS: Yes, I think that as we continue to look at opportunities for the modernization of CRA we want to look at both place- as well as people-based strategies.

Originally, it was more place-based. But now, with the current economic environment and what's happening to neighborhoods as well as new strategies in the community development arena, where we're looking at ways to de-concentrate poverty and ultimately give people what I consider the greatest American dream, which is one of choice. As housing affordability is becoming more accessible in suburban areas and non-poverty-stricken areas, people are picking up and being able to move around, but they are still in need of quality access to capital and to a variety of financial services.

So, it's neighborhood-based strategies where CRA could be beneficial, but also people-based that are still low-mod (low-moderate income) in their economic status, but may be moving to a variety of different areas around a particular region.

MR. GOLDSTEIN: One second, Jennifer. The one piece that we took that discussion just a little farther was not only to think about sort of the traditional bifurcation of people- and place-based, but also to think about product-based, with the idea towards again thinking about the context within which CRA was born. It was very bricks and mortar. There was an institution here, it was receiving deposits from the people within its footprint, and now that whole thing has changed. So, we're going to look at the issue as well, not only the people, but also thinking about the products and the extent to which the delivery of product regardless of place can meet the underlying goal of the CRA.

Jen.

MS. TESCHER: Just two additional points. Several people have already talked about expanding CRA to include not just loans but other kinds of services. I just want to acknowledge that the Fed and other regulators have over the years, the last few years in particular, done an excellent job of adding all sorts of products -- remittances is a good example -- that you can get credit under CRA for.

It's not so much that we haven't added it as something that counts. It's that we haven't gone the next step and figured out how to best measure it and give credit for it. I just wanted to put a finer point on that. We've all thought about all the great things that should be added. In fact, we've added a whole boatload of things. We just haven't properly counted and measured them in the evaluation process.

The second point I would make is as we're talking about expanding CRA not just to cover different kinds of products and services, but also to cover different kinds of institutions, particularly non-bank and non-affiliated non-bank institutions, we really can't have this conversation divorced from the broader regulatory reform conversation, because I think there's a real lack of clarity around how those institutions are going to be regulated and to have them subject to CRA on the one hand and have that be divorced from how they're regulated and examined on the other presents some real challenges. I think that's a really important connect point to make as we're having this dialogue over the course of the next several months.

MR. GOLDSTEIN: Somebody brought up a moment ago this notion of the -- I guess it was Mike -- not just the quantity of the credit that's delivered, but the quality of the credit. Patty had some interesting thoughts about that yesterday.

MS. HASSON: I think as we think about what is happening and the test around investments and loans, there are many loans that were made and we've seen some great studies that CRA was not the major cause of what's happening in this world.

However, I've always felt strongly that there is so little emphasis on the service test and a lot of the service test is the services that prepare people for homeownership -- to really do the quality, get them along the path to understand the benefits of homeownership and what they need to do.

And there was a lot of emphasis and a lot of individuals I would talk to in CRA in our area who would say, you know, but they're coming in looking at loans and how many loans you're doing.

So, I think it's really important that we think about, as you're rewriting this, that we need to be thinking about how do we also help people along that path and not just the loans themselves, but make sure that we're making those quality loans and that people are prepared for the long-term sustainability of owning that home.

MR. GOLDSTEIN: Another piece of our discussion was not only the provision of credit -- and others have touched on it in their comments so far, but a little more explicitly now -- not what happens at the front end, but at the back end of that credit. That's where Saurabh had some interesting notions as well. After the credit's provided.

MR. NARAIN: Yes, one of the thoughts that's being discussed in the industry is around the notion of if people do not perform well under the CRA Act, then the biggest dinging factor was the fact that they were not allowed to do M&A. Now, I sort of overheard some conversation in the corridors as, well, most M&A is done. Maybe, maybe not, but I mean how many do you want to stop.

Can we also sort of change the discussion, make it more forward-looking, more incentive-based? Can we think of a system wherein if an institution does do well under the CRA provisions as defined by the law -- and Jennifer's right in terms of measurability and getting clarity on that. If their performance goes from X to 2X, just to oversimplify it, goes from X to 2X, then their "incentives" on some form increase from Y to Y plus delta. If we can bring in some sort of a positive correlation between the performance of an institution and the kind of incentives they get -- be it the federal deposit insurance benefits as well as any other kind of tangible benefits. I think we must move forward in actually doing business, providing CRA loans and CRA services, as a good business proposition.

MR. GOLDSTEIN: Okay. The discussion then turned in a few different directions. One of which was to think about of all of the issues that we would like to cover in this group and to address with respect to CRA, there is a notion that some of this can be dealt with through simple guidance and clarity of the intentions of the Federal Reserve with respect to how institutions should be complying with the laws that exist or how it's now interpreting that law.

The next step -- and the next more difficult step, really -- is this notion of regulation. But the third and most difficult, we think, is legislation and actually getting in there and carving that up.

So, we're going to look at all these things, I think, with an eye towards trying to put our issues into categories of that which we can deal with through each of those different things. I know that Mike had some thoughts about how to sort of carve those things up.

MR. CALHOUN: And I think we had assistance at the meeting from Allen Fishbein, who's been particularly helpful on this issue and to look at the different areas it could be done. But my perspective is I've now worked for over five years on mortgage reform legislation in the Congress, having spent an extraordinary amount of time on it. I think one of the data points we got yesterday was, well, CRA was on the front burner and it's now been pushed way back on the stove. We had the similar experience with mortgage reform that the Board chose not to wait, but to wisely use its existing HOEPA authority to go ahead and put some protections out. And even with their effective date not in effect yet, they still have changed the market, I think. They had an impact immediately on the market.

I would urge that we look for ways to do that in this context as well, to not operate on the assumption that even though CRA reform is a decade overdue, the fact that it's a decade overdue may suggest that it may not be enacted this session or next session and there should be efforts that take that contingency into account.

MR. GOLDSTEIN: I would say that the last, but certainly not the least of the issues that we discussed yesterday -- and hopefully we'll get some more discussion over the next coming months -- is not only the extension of the CRA to a different set of institutions per se, or perhaps a different set of products, but rethinking a little bit about the coverage of the CRA with respect to the categories, the demographics, the economics of people who would be covered, and Shanna had some perspectives on that.

MS. SMITH: In supporting what Saurabh has said about expanding the institutions that would be covered and Greta's point about people as well as place, I think it's important when we were all -- well, a lot of us were working on CRA in 1977, we were looking at the extension of credit, limiting it to focusing on low- and moderate-income neighborhoods. And that was very good because it included low- and moderate-income white communities as well as communities of color.

We now have credible research showing that -- research by the GSEs, some of the regulators, the consent decrees by the Department of Justice -- showing that African-American and Latino communities were really targeted by subprime lenders and predatory lenders for products that they really didn't deserve to have. They were qualified for prime loans.

So, one of the things we were talking about is extending coverage under CRA for those members of the federally protected classes perhaps under the Fair Housing Act and ECOA. So, we would look at it in this sense: Because low- and moderate-income communities alone don't cover all African-Americans, Latinos, and Asian-Americans individually or their neighborhoods -- because unfortunately America's still very racially, ethnically, and economically segregated -- that if we look to doing the people part that Greta was talking about, we'll be helping both low- and moderate-income people of all races and nationalities, but we'll also be targeting people of color and women and people with disabilities, for example, who have been the victims of the discrimination in the neighborhoods and the segregation.

When you look at the fact that the non-depository and mortgage subsidiaries haven't been covered, they're the ones who filled that gap, so to speak, when the banks weren't making high-quality loans to qualified African-Americans and Latinos.

Now, some people might say, well, you know, you have the Fair Housing Act and it should be addressing these issues legally. And, of course, it can. But if we extend the CRA, I think with the lenders and the non-depository institutions, the credit unions, and the insurance companies, by extending this coverage, I think we'd actually reduce fair lending litigation because we'd have all these institutions now focusing beyond low- and moderate-income issues to also look at the other protected groups. I think it would open up doors. I think it would promote residential integration, both racially and economically, in the country.

MR. RHEIN: I guess we have a different perspective, and that is if current regulations aren't appropriate, then work on those regulations. To me, you start to dilute what CRA's really about. Its success was based on the fact that it was specifically targeted on low- to moderate-income. It didn't get into gender. It didn't get into ethnicity. We have ECOA. We have fair lending. Our feeling is if the enforcement around those areas is inadequate, then that's what you ought to be working on as opposed to trying to get something like CRA to be an umbrella over all these different areas.

And if it's not, if those areas aren't being covered by non-regulated institutions, then that's what the law should be focused on -- go after those institutions around fair housing and ECOA and those types of things. I just think it's a mistake to try to get CRA to be addressing things that are already covered by other regulations.

MR. CAMERON: Yes, Ira, let me support what Kevin is saying.

It seems to me that all the comments that we're hearing from community activists illustrate definitive community needs and laudable needs. But they're not needs that are subject to CRA and, in fact, what we ought to do is get into a zero-based evaluation of, let's say, enforcement of community responsibility rather than CRA and put this in a completely different guise or under a completely different regulatory structure. One that we can start from the beginning, from the ground up, and if we want to enforce every business in every community to take responsibility, that's well and good. That's a policy statement that our legislatures and Congress can make. But it's not CRA and we shouldn't confuse it as CRA.

MR. GOLDSTEIN: Paula.

MS. BRYANT-ELLIS: I just think that's an important point that I want to chime in here for the third time and say that I would like to see the Board give consideration to not burdening CRA with all of these other responsibilities. We have the other regulations. We have them out there.

If we're going to think about updating the CRA regulation, we should probably also think about updated HMDA as well as fair lending because they do closely align. It is the HMDA data by which we capture all that information and we can look at those fair lending issues. So, I believe CRA, fair lending, HMDA are very closely aligned, but I don't think that CRA can be all things to everybody.

There is absolutely an opportunity here to think outside the box to expand CRA. It has some flexibilities in it, it has some constraints in it. But I think to Kevin's point and to Alan's point, we don't want to burden CRA to try to be all things to everybody. Let's deal with the regulations that are out there. If we have a fair lending issue, let's deal with fair lending and update fair lending as well.

MS. TINNEY: Just one add-on point. By including fair lending and ECOA in CRA, you begin to dilute the impact in the future perhaps of the very strong efforts that we've all been making in low- and moderate-income communities, and I think it would not be wise to do that. We really, especially now, need to be rebuilding our communities that are low- and moderate-income.

MR. FALK: We've spoken about expanding CRA responsibilities to non-depositories or to private companies that do not get the quid, shall we say, for the benefits associated with and the responsibilities that come with CRA.

When you expand it to non-depositories and other companies that do not get the benefits of CRA, then those companies have responsibilities without the benefits. So, I think for clarity's sake and for simplicity and basically for fairness, if you're going to get the good, you get the responsibility. If you're not going to get the good, then I think that adding that responsibility to those companies is ultimately more burdensome.

MR. GOLDSTEIN: Joe, I think that's a point that we did discuss a lot about and really trying to understand as much as we could how to evolve the notion of what the good is. The good is very different today than 1977, and the question is really sort of keeping an eye on that, as you said, the quid.

I would say lastly, and in the interest of time, lastly, it gets to Paula's point about HMDA. There is a data issue that goes along with all of this and the idea of being able to gather more, deeper, richer information about the activities of the institution and or the institutions and what might be the best way to do that and how to look at it and do it in a way that you're shining a public light on it, like CRA and HMDA were designed to do when they were created. Again, I hope I don't get a funny look from Saurabh, but he did have a point about data. I'm sure about that.

MR. NARAIN: I think Mike's going to talk about some of the sub-working groups that have been formed by the CAC. Kathleen Engel and I are looking at some of the data issues -- additional data that can be collected by the regulators or, rather, defining the frameworks. What kind of data would be useful to who, and if we can expand the data collection and help the CRA examination process. Because ultimately, as we are sort of redefining CRA, we have to think about CRA redefinition of three counts -- the ease of adding people, how do you measure, and then how do you enforce.

One of the things that Kathleen and I are working on to get inputs from industry, consumer advocates, and researchers to say what are the kind of data points that we should be looking at and why would it be useful and how would it be useful to the regulators and to industry as well.

So, that's a small working group that we've formed and, you know, hopefully something nice will come out of that. Kathleen, you want to add something to that?

MS. SAWADY: Okay. Well, thanks. I'm going to exercise the prerogative of the chair to say the last word on that. We have talked about part of the good as a safety net, as providing a financial safety net, and I think even Joe will agree that it may be impossible to predict ahead of time who are the companies that may benefit from that.

So, one suggestion is to look at it in the context of too big to fail and maybe too connected to fail -- to include some institutions not by virtue of what they do, but by virtue of what their level of connectedness to the economy is, assuming that those are the ones who are going to benefit from a safety net if we get to that.

Just another thought.

Thanks for the wonderful discussion and there are 15 minutes of recess. We are going to convene at five minutes after 11:00. Thanks.

(Whereupon, the above-entitled matter went off the record at 10:53 a.m. and resumed at 11:09 a.m.)

MS. SAWADY: We are going to start in a minute, please. I love it how it gets quiet all of a sudden. One second. We do have two very important and quite heavy topics to discuss and, Patty, you have the privilege of guiding us through both of them, I guess. So, thank you.

MS. HASSON: Okay. Thank you, Edna.

MS. SAWADY: Before you start, let me just put the frame around it and just to tell you that I've just mentioned to Governor Duke, who's sitting to my right, that poor Patty has to lead both those discussions and her response was, well, she can handle it. Just wanted to acknowledge the extra effort, Patty.

In the first quarter of 2009, about 12 percent of mortgage loans were delinquent or in foreclosure, the highest level ever recorded by the Mortgage Bankers Association survey. The number reflects the impact of the recession and unemployment, particularly on prime borrowers. For the first time, prime loans were the largest share of quarterly foreclosures. In addition, according to Moody's, about 20 percent of homeowners are underwater. That is, they have an unpaid principal balance greater than the current value of their home, which is a significant predictor of default.

Yesterday, members of the Housing and Community Development Committee discussed loss-mitigation efforts such as the Administration's Making Home Affordable Program, the performance of modified mortgages, and other issues related to foreclosures and foreclosure prevention.

So, it is at this point that I turn it over to Patty.

MS. HASSON: Okay. Thank you.

We had an engaging conversation yesterday around the SAFE Act (Secure and Fair Enforcement for Mortgage Licensing Act) and addressed particular provisions to offer input to the Board on its rulemaking within that Act. And while it's not a direct conversation and it's not on the agenda today, I think that there's some really valid points that were made yesterday that individuals would like to bring up that will have a direct impact on the foreclosure prevention conversation.

So, Kevin.

MR. RHEIN: Thanks, Patty.

We had a couple of things we thought would be important for the Board to clarify around SAFE. The first was whether there's a need for loss-mitigation people to be licensed under SAFE. The general feeling -- and I don't know that there was a lot of push-back from the group -- that they should be, we think they should be excluded. In part, we think it'll slow down the process. A lot of these programs that are occurring are under the Obama modification plan, so some of the flexibility around what they're doing really doesn't necessarily require the licensing.

Plus, there's many people in the process of doing a loan modification, so trying to understand where in this process loss-mit people might have to be licensed or not licensed, we think, is a complication. So, that would be one general comment.

The second thing is, are we building capacity to be able to handle national banks. Right now, the registry is started for state institutions, but when you start to bring in national lenders, for Wells Fargo, we will have somewhere between 45,000 to 60,000 people that will need to be licensed under the SAFE Act. If you're talking about fingerprints on all those people, has the Fed and the infrastructure been beefed up or is it preparing so when we hit that 180-day time line, are you going to be able to deliver on the process to get these people their actual identifier or not. We're very concerned about whether the infrastructure's being built in order to do that.

MS. HASSON: Okay. Joe and then Terry.

MR. FALK: Well, the implementation of the SAFE Act, I understand the statutory limitations, but this happens to be my sort of sweet spot, on the SAFE Act.

I'm very disappointed that the Fed didn't take some expanded steps to do more than just the minimum requirements under the SAFE Act. The entire state-chartered, small mortgage lender, mortgage company, mortgage broker, mortgage banker construct has no grandfathering. All loan officers in all of these shops throughout the country have not been grandfathered in. So, each and every loan officer throughout the country is going to have to be retested, re-fingerprinted, relicensed. Every state is changing their regulations and ultimately going into the registry.

Under the SAFE Act, the only requirements for the federal depositories are for those loan officers to go through the fingerprinting and get the unique identifier. To me, there is a problem with loan officers for their training, their testing, their understanding of truth in lending, of state laws, of ECOA, of responsible lending practices including ethics training that is required. I would urge the Fed and other agencies to do more to ensure that loan officers working for federal institutions have minimum standards of education, of testing, barring criminals that is currently in place for the non-depositories and the state-chartered institutions.

MS. HASSON: Okay. Terry.

MR. THEOLOGIDES: Stepping aside from the originator issue that Joe's talking about, in terms of loss-mitigation personnel, I feel very strongly that the Fed needs to exclude those from the coverage of registration that would apply to originators under SAFE. Beyond the scope of just the Fed's jurisdiction, how the Fed approaches that loss-mitigation personnel issue, I think, will have a ripple effect into the states. The requirements among the state licensing statutes, if loss-mit personnel are included in that, become more onerous and could impede the home preservation and foreclosure prevention activities. If the couple hundred loss mitigators in my shop had to get licensed and tested in 50 states under potentially unique statutes in each of those, they'd spend all of their time doing that instead of helping people preserve homeownership.

And so, I think that there's an example that the Fed can set by staying true to the intent of the SAFE Act, which was focusing on a baseline of licensing regulation for originators and not necessarily bootstrapping the loss-mitigation personnel who are in a very different sort of situation and relationship with consumers into this regulatory framework.

MS. HASSON: Okay. I think Kirsten and Mary will finish up on the SAFE Act with their comments.

MS. KEEFE: I agree with not regulating the loss-mit personnel, although I am a little bit curious about how they are incentivized and I would love more transparency on how the loss-mitigation departments work. But generally, I sort of agree that somebody goes to a mortgage loan originator or a mortgage broker to get a loan, and I think that that's a much different situation than somebody working with loss mitigation.

I'd also like to add that I'm not in favor of licensing what we call in New York state the distressed property consultants -- these independent foreclosure consultants that offer to help folks work out some sort of loss mitigation with the servicer for a fee. This is on the table right now for discussion in New York state, and consumer advocates are vehemently opposing licensing this group of folks. We haven't seen really any value added from this for-profit sector. In New York state, like many if not all states, we have a very strong network of nonprofit housing counseling agencies. We think that licensing these for-profit consultants would legitimize a business that we don't see any legitimacy in at this point in time.

In one state that I know of that has licensed or does now require licensing of these distressed property consultants, the last I heard only four entities applied for registration, and we are quite certain that there are far more than four entities operating in that state. So, I don't think licensing is going to have the desired effect of either deterring the bad guys from acting in this state or really getting them under any purview of regulation.

When somebody is licensed, it's difficult to get them unlicensed. There has to be, I think, very strong oversight of any licensing. Generally speaking, at least in New York when this issue has come up, and I would really encourage the Fed also to follow what we're hoping will happen in New York is not to license and legitimize these for-profit foreclosure consultants.

MS. HASSON: Mary.

MS. TINGERTHAL: There's also a request in the proposal for comment on whether to exclude from licensing requirements individuals that do refinancings when the refinancing is with the same institution and does not involve cash-out.

We discussed yesterday that we believe that refinancing should be included because there is the possibility that you can be refinanced into a worse product that may appear initially to benefit because you could have a lower payment initially. You could go from a fixed to an ARM, for example. We think that there's enough requirement for sophisticated knowledge about mortgage products that those doing refinancing should be covered as well.

MS. HASSON: Okay. Kathleen and then we'll move on to foreclosure prevention.

MS. ENGEL: I just have two quick comments. One is that to the extent that it's possible to link these unique identifiers to the HMDA reported data, that would be very valuable, particularly in light of the great work that Glenn Canner has done showing that channel seems to be really important. It might be a way to understand whether there are or who the rogue brokers are out there and rogue loan officers -- not to single out the brokers, Joe.

MR. FALK: Or rogue bank loan officers. Rogue anybody.

MS. ENGEL: All rogues. And the second thing is that --

MR. FALK: To deny that it exists, you're not reading the newspapers.

MS. ENGEL: And then the second thing is that in terms of the consumer access to the information, I think that it would be advisable to have that be a web-based portal so that consumers can do with brokers and loan officers what they can do now with some of the websites for looking up doctors' malpractice records and things like that.

MS. HASSON: Okay. Shanna.

MS. SMITH: Mr. Litton gave a very compelling presentation for me yesterday about loss mit and people, but I want to go back to what Kirsten was saying, too. I think we need some transparency and some data that shows us why there are more people defaulting a second time. I think there are probably a lot of reasons that that happens, but I think before I'm comfortable saying we shouldn't license them, I'd like to see evidence about why. Because if some people are doing a loan modification and they're not re-underwriting or they're re-underwriting inappropriately, I think it would be better for us to have this data, from Saxon and other companies, before we say that they don't need the same kind of training that other people need.

MS. HASSON: Which is a great segue. I think, Larry, you had some comments around the Making Home Affordable Program in particular and where we are with foreclosure prevention.

MR. LITTON: Yes, ma'am, I'll be happy to talk about that. This is my favorite issue to talk about. If I get jazzed up a little bit, just tell me to calm down. I'm going to put the microphone a little bit away from me here.

So, as it relates to loan modification, this is a topic I feel very strongly about. One of first issues I'd like to point out is there's been a lot of industry studies with regards to the redefault rates. One of the fundamental issues that I think that we need to wrestle with is that we need a little more uniformity in terms of defining redefault rate because in the subprime and Alt-A product space, using a thirty- or sixty-day delinquency rate as a redefault rate is probably not appropriate, given the fact that a lot of these folks are lumpy payers even when times were good.

Whenever you modify a loan, if they're thirty or sixty days delinquent six months later, that's not necessarily a bad thing. They're just back to the pattern that they were before they stopped paying and got six months past due.

I think that that's one very, very important element because people are judging whether some of these programs are effective or not, and they're throwing out 60 percent redefault rates. And those redefault rates may not be based off of a ninety- or 120-day delinquency number, which is probably a much more appropriate measure, again, given the lumpy nature of the cash flows associated with some of these loans.

The second point I want to make with regard to the HAMP (Home Affordable Modification Program). The company that I run in the twelve months leading up to March of 2009 had done 44,000 loan modifications, which represented about 15 percent of our portfolio. Since HAMP came out, it's really slowed down loan-modification volume, and here's why. I think you guys need to understand what some of the impacts and unintended consequences would be.

Having a streamlined process to be able to document income, I think, is very important, particularly for the subprime and Alt-A consumer. Doing a full-blown documentation, re-underwriting of the loan, looking at back-end ratios, et cetera, it takes the processing time frame from what used to be two weeks to something that's now eight weeks, twelve weeks, or even longer because many of these consumers will not provide the information. Their view is, hey, I got a loan three years ago. I didn't have to provide proof of anything. Now you're asking me to go in and provide evidence of all this other documentation, and it's slowing the process down.

And then the last point that I'd like to make, and I'll shut up here, has to do with potential unintended consequences regarding redefault. What I'm really worried about with regards to HAMP is that a consumer redefaults and, prior to HAMP, a lot of servicers would go in and either re-modify if the conditions were appropriate or re-look at other things to maybe try to rehabilitate the loan.

Now, with HAMP, though, I'm afraid the borrower's going to get one bite at the apple, and then it's off to foreclosure. I think servicers are very gun-shy about what the feds -- when I say the feds, I mean Freddie Mac and others who are going to be policing this program -- do on subsequent audits to come in and audit servicers after they've gotten these incentive payments. I think that you could have unintended consequences, and that could backfire and actually drive up default rates later.

I didn't mean to be so long-winded, but that's the issues.

MS. HASSON: Okay. Thank you.

MR. LITTON: Yes, ma'am.

MS. HASSON: Terry, you wanted --

MR. THEOLOGIDES: Sure. As the other servicer, or another servicer in the room, I'll add a couple of additional comments.

I think on the positive side, the clarity or at least the uniformity of HAMP is helpful in terms of starting to manage expectations. Particularly when servicers work with intermediaries like loan counselors, there's an understanding that there's not thirty-one different flavors depending on which servicer it is, but there's more consistency about what will be expected in terms of documentation, how it will be underwritten, what payment will be solved for.

On the flip side, there were some lost opportunities in terms of that uniformity. There are substantial differences in terms of how Fannie- and Freddie-owned loans need to be modified compared to those in private deals. So that adds a degree of complexity, more room for error, more confusion about, well, the last time I called you from counseling agency, you told me you'd do it this way. Well, that loan was owned by these guys, this loan is owned by another. I think because these rules are being set from the top, it's not -- they ought to be uniform.

The other challenge has been with the speed of execution and the immense pressure to roll this out. A lot of details that are necessary operationally just have not been established. While I feel for the people at Fannie who are acting as agent for Treasury to administer this, servicers need clarity to very granular, very specific questions, and sometimes those just aren't forthcoming and servicers are left to sort of do their best and continue to monitor the releases.

Typically, then when new information is released, there's often been very little, if any, lead-up time. OK, this is the new model. Well, to the extent these are programmed into computer systems, into training, into scripts, you're technically out of compliance the day they come out because they're in effect the day they come out. That, combined with the perception that because this does involve funding from the taxpayer, there's angst about, wow, I have imprecise guidelines. I have unrealistic roll-out times, and yet I have the potential of very severe consequences if I screw up. That may be deterring other servicers from participating in what I personally think is a step forward and a good plan.

I think HAMP will result in lower redefault rates, but they're not going to result in what I would consider low redefault rates. I think it's important to know that even if everyone follows it to the letter of the guidance, there's unemployment, there's severe distress. Many of these consumers are tapped out in trying to stay in their home and meet their other financial obligations. Redefault rates will never get down to what you would expect had these been the origination guidelines with an otherwise healthy consumer.

I think the other big looming issue that HAMP hasn't dealt with is unemployment. I mean, at the end of the day, many, many consumers are still being turned down for HAMP mods. There were foreclosure moratoria in place that prevented those foreclosures from proceeding. Now those are being lifted, and you going to see those REO coming onto the market and that presents challenges for communities and property values. I think people need to be aware, and that probably floats into the next discussion we'll have about neighborhood stabilization.

MS. HASSON: Okay. Thank you, Terry. We're not there yet. Patricia, did you have some comments?

MS. DUARTE: Yes, I just wanted to -- based on hearing both servicers, it explains the frustration that we're still feeling in the nonprofit sector and the foreclosure intervention counseling program. For all the reasons that they stated, there's still a lot of confusion. The consumer is frustrated.

Although NHS Phoenix benefited from the National Foreclosure Mitigation Counseling Program -- we were able to double our staff, we went from two counselors last year to four this year -- it's hard to measure progress. But we can say that last year in the entire year, we helped 144 families stay in their homes. There were 144 foreclosures prevented. This year, as of last week, we already have 213. So, there's a 48 percent increase. We are seeing some progress, and we're all very encouraged.

But it seems like it's still a lot of the status quo that was happening last year, the confusion with the lender-servicers still having the right numbers and the response time. But I understand why it's happening. I think it's still very early to tell the success of the Making Home Affordable. On the refi side in Arizona, it's not going to help us much. The Phoenix metro area had about 65,000 foreclosures just in the last eighteen months.

One of the concerns that I have is the National Foreclosure Mitigation Counseling Program rolled out the first time with $180 million. The second time, an additional $180 million. Next year, it's $50 million. The problem is not going away, and it's a serious concern because $50 million is not going to help us keep a lot of our foreclosure intervention counselors.

The other concern is that we still have way too many for-profit -- they call themselves loan modifiers, but they're the distressed consultants. I started to see Ocwen as one of the lender-servicers that is starting to ask the consumer, are you paying for the service? If we would have a movement from the lender-servicer community helping the consumer understand that they don't have to pay someone, then that would help us. We don't have to regulate them and license them. They would just hopefully go away if the lender-servicers just emphasized that people don't have to pay to get help.

MR. RHEIN: A good advertising campaign.

MS. HASSON: Kirsten and then Tom and then Jim.

MS. KEEFE: One thing in my experience that this program has done, and I really love the President and Treasury and the Federal Reserve for moving the discussion in the direction of loan modifications based on affordability. I'm hearing that even servicers who have not signed up to participate in the program are starting to do loan mods based on a 31 percent debt-to-income ratio, and that's huge. If only lending had been an affordability model five years ago, we wouldn't be here. But I think that's a really positive thing.

I think Terry mentioned that one piece that's left out of the modification program is the unemployment piece. I would add the second one is the fact that so many homes are underwater has also not been adequately accounted for, and I just feel the need to continue to press that we need principal write-downs. I am learning more and more about the constraints of the servicers to effectuate principal write-downs. But I really think that that is a necessary piece of the puzzle. It's not until we do massive principal write-downs in a lot of cases that we're going to get to low default rates, not just lower redefault rates.

I would echo the concerns that Patricia raised. The consumers are also being frustrated with the lack of the details of the program. I think, one, we're still looking for transparency on the net present value model. Consumer advocates are very interested in seeing what's going into that and how that's playing in so we can have more informed discussions with the mortgage servicers when doing the individual loan modifications.

There is still -- you can't get a full list of the companies that are participating, which seems sort of like a simple thing that you'd be able to put on the website, but not all the participating lenders are being put on it.

I mentioned yesterday in the meeting -- and I appreciate why it has happened because there has been a rush to this, and I think the servicers are doing all that they can at this point to train folks -- but on the 1-800 customer service level, there is still very much confusion even about whether or not that own servicer is participating in the program. So, anything that the federal government can do to try to shore up the training on the 1-800 level.

I just want to sort of stress that that 1-800 number is really key. I know a lot of servicers are developing separate numbers for legal services folks and housing counselors to go to directly, but that 1-800 number is getting folks who are losing their houses.

And I heard recently that NeighborWorks did a training of their housing counselors in LA on suicide counseling because people who are losing their houses are much different than people who are just behind $5,000 on their credit card. I really think we need to shore up the 1-800 numbers, the customer service, recognize the situation that these folks are in, recognize what is at stake for them, and really come up to speed very quickly on that piece of it.

Another detail that's sort of been lacking, I think, is what these loan modifications are looking like and what the releases are. My fear is that folks are releasing extensive claims and defenses if they are getting a loan modification in which litigation had not yet been initiated and that those contracts are not having any review by a lawyer. Maybe they're being reviewed by a housing counselor and hopefully that housing counselor might be linked with a legal services lawyer. But these are modifications of, again, mortgages, and we haven't provided any sort of review for homeowners of these potentially very, very complicated contracts. What got a lot of people into the mess in the first place because they didn't have legal representation at the table or adequate legal representation at the table.

And then the final detail that I think we're waiting for is tax consequences. I know Treasury has been asked again and again about the tax implications for the homeowners for the reduced interest rates, and I think we really need some guidance on that piece of it.

MS. HASSON: Okay. Thank you. Tom.

MR. JAMES: Yes, I just wanted to emphasize Patricia's comment and also Kirsten on the modification services. We're seeing enormous problems there in law enforcement with respect to modification or counseling services that find people in distress. These are the most vulnerable people in the world, and they are susceptible to any kind of con, and this is a con. That up-front fee for the counseling or modification is the target.

There are a lot of states that are enacting statutes, including Illinois, that are trying to get at this problem, but there's got to be overall -- I think it's just a flat-out unfair practice at this point in the game to allow an up-front fee for a modification. We need a federal answer to that question.

MS. HASSON: Okay. Jim.

MR. PARK: I think that's a very good point, Tom. You see this all throughout the country, these sort of scam artists that are taking money up-front, and something strong like that has to take place.

Let me just go back to MHA real quick. I think Terry and Larry both hit on some of the good and the bad of MHA, and clearly there are some limits. I think we're doing some important things with it. Clearly, things like total LTV (loan-to-value) limits make it irrelevant in certain markets -- places like some parts of California, Arizona, Florida, Nevada, and other places. That kind of limitation makes that product almost irrelevant.

Las Vegas, I think, has -- what, two-thirds of mortgages in Las Vegas are underwater, and in Phoenix, it's more than 50 percent, I believe. So, there are going to be absolute limitations to how effective these kinds of products will be in those communities and whether loan modification really will be the long-term answer. It'll be one of the answers, but it won't be the overall answer.

I think one thing that we do really have to think about, and I know Treasury put out as part of this MHA effort a short-sale effort. I do think we need to think about that in a more coherent and consistent way, because that's the only way, I think, in these heavily underwater communities that we're going to stabilize the real estate market for the long haul.

I know we want to focus on home retention, loss mitigation, workouts, but I do think we need to run a parallel track around short-sale effort full-bore.

MS. HASSON: Okay. Kevin.

MR. RHEIN: Yes, I just want to give four very specific examples of where we're running into issues with the current HAMP program, and a lot of these are operational things.

The first one, just to be very clear, is the Treasury NPV (net present value) model is not defined yet. There is an agency model on NPV, but getting into the actual publication of this NPV calculation -- we can't be transparent on something we don't know what it is. So, if there's any way to accelerate that.

The second thing is there is a requirement under the modifications to establish an escrow account. In many cases, the mortgages that you're modifying never had escrow to begin with. That really is difficult, especially in this trial period. We would suggest that we should certainly be looking at the escrow payment in qualifying for the modification, but if we could defer the start of that formal escrow until people are successful through the ninety-day period of time, you might start to see more throughput because the creation of that escrow account is getting in the way of some of these deals getting done on account that weren't escrowed before.

Two other things are the timing of the first modification. The timing of the first payment after the trial period is effectively the next day, and so I think there needs to be some clarity in the language. What ends up happening is you have to start to prepare for the success after only sixty days because they have to know what their payment is in final at the end of the trial period. The linking up of what happens coming out of the trial isn't making sense. Effectively, you need another thirty days, and some of you guys that live servicing everyday might want to chime in.

And then the last thing is there is no mechanism yet that explains how Treasury's going to fund and have servicers report on the monthly incentives that are supposed to get paid to the investor. I think if investors started to see the flow of some of these payments, you might find that they get a little more excited about the opportunity to do more. It's like a basic Psych 101 on positive reinforcement. If they start to see some money from doing mods, maybe they'd be more willing to do more.

A lot of this stuff got way out there publicly, but if the internal mechanisms aren't there, you're not going to see the flow-through that we really all want in this.

MS. HASSON: Okay. Which leads to a great comment, Mary, on the investor community.

MS. TINGERTHAL: One of the things we talked about yesterday is there's a lot of evidence that the investors are really still not at the table in terms of one of the important parties that have to really buy into mortgage modifications, especially if we're to have any degree of principal write-down. I think the very fact that the NPV calculation still doesn't exist is testimony to the fact that there just has not been agreement space between the servicers and the investors. So, just at a fundamental level of getting the investors to the table around Making Home Affordable is one layer.

But, I think there's a much larger layer of what appears, at least to me as an outside observer, that of all the big topics that are being discussed among the various agencies in Washington, the dialogue I don't hear is what are the lessons we've learned? The sort of operational, regulatory lessons that we've learned from how hard it is to deal with securitized assets when there is a systemic failure.

As we look at regulation and re-regulation within the securities industry, we also need to think about how we build in some of the operational mechanisms that can allow us to have securitized mortgage products in the future, but without having these ugly consequences of having investors and servicers be at loggerheads -- when really if you got them in a room and they weren't bound by regulations, they could agree with a handshake. But, because of the need to revisit things like REMIC regulations, et cetera, those things just simply can't happen without a court of law.

I would really encourage the Federal Reserve to insist that that interagency conversation about securitization and the roles of investors and servicers in making sure that we can use securitization going forward as a very necessary financial vehicle, but to really fix some of the underpinning so that we don't face this again.

MS. HASSON: Okay. Larry. Then I'm going to finish up with my comments and then back to

Edna.

MR. LITTON: All right. Great. I think Mary brings up a great point in that over the past couple of years as this crisis has evolved, some servicers would have restrictions on them because of the deals that they serviced had restrictions in the deals on modification levels, et cetera. Some of the rating agencies had certain restrictions. I think having uniformity on that prospectively makes a lot of sense.

Generally speaking, though, investors -- and again it depends on where you are in the capital structure, whether you're a AAA bondholder or a BB or a residual holder -- but generally speaking, investors have been supportive of responsible loan modification.

Now, having said that, depending on where they are in the capital structure, some of them may or may not like principal reductions, et cetera. Again, it kind of depends on kind of where you are. But I am a huge believer in that at the end of the day, if principal is not reduced, you are pushing this problem out into the future because property values are probably not going to appreciate at the levels that are needed in order for these borrowers not to be long-term tenants. I think that is a fundamental issue.

MS. HASSON: Okay. I just wanted to finish up with some thoughts. I'm on a listserv that people put out, counselors put out their problems. I had a bunch of them compiled to see trends, and I think a lot were brought up today.

One that was not, I think, has to do with -- and Kirsten has said it in the past -- the support for legal services for individuals. I continue to see comments on this listserv, and I'm thinking there's no way you could train a counselor to do that around bankruptcy, reaffirmation, et cetera. I want to put out that I think that that still has to be on the table.

I want to add to it that as you think about the loan-modification personnel and trying to get them up to speed, I think you have the same issues on the housing counseling side. In an environment, especially in Philadelphia, where some entities are gearing up, whether it's for loan-modification servicing or refinances that are happening in this market, it's really hard now to find qualified individuals who have that mortgage experience who want to earn what we pay, quite frankly.

But, in the midst of that, you're trying to find and train people in a very tight time frame. I actually do sympathize with the servicers on that point. I think if we think about data collection, it goes to what we've been saying all along. There are probably loan-modification people that -- if some of you are in your shops pulling reports by the actual person, you might see trends that really would shock you and say, oh, I've got to retrain this person or maybe this person's too aggressive and that's why their redefaults are so high.

On the same side, it's really difficult from a housing perspective when they have the data. We have to track down these individuals who are very mobile -- if they didn't stay in their homes, et cetera -- to try and find that info. If the industry could give us back the data as to what happens ultimately with that client and what the solution is, we might see trends among our counselors that also would help us either to retrain them to say maybe they're being too aggressive with what they're doing with that client, on the same vein.

I know that's a wish list, but I think ultimately it would help the entire industry. Again, it just goes to the importance of data and how to use it.

So, Edna, with that, I'll turn it back to you on the NSP.

MS. SAWADY: Thank you. Well, we are moving to a very related topic of neighborhood stabilization. Despite efforts to prevent foreclosures, not every foreclosure can be averted. The effects of foreclosures are felt not only by the families that lose their homes, but also by surrounding communities, particularly in areas with concentrations of vacant and foreclosed properties. We talked about it yesterday quite a bit. Specifically, members of the Housing and Community Development Committee discussed strategies and challenges in the effort to stabilize communities affected by foreclosures including the implementation of the Neighborhood Stabilization Program.

And it is now my great pleasure to get it back to you, Patty.

MS. HASSON: Thank you. I'm going to actually punt it right over to Mary because I think she did a great job yesterday bringing us up to speed, and I think everyone here would like to hear where the NSP stands.

MS. TINGERTHAL: Well, it is the topic of the day in communities across the country. The NSP program passed last summer, began to be implemented October 1st last year. But what is not well-known is that HUD did not really provide contracts to states and localities until April 1st of this year. So, counties, cities, and states are currently in the process of implementing the program, and it's going much more slowly for a number of reasons.

It exists in a very, what I would call, clunky regulatory environment because of the fact that the NSP program is layered on top of the Community Development Block Grant Program.

On top of that, many grantees under Neighborhood Stabilization, particularly in places like Florida and Nevada and Arizona, are getting much, much larger allocations of dollars than they have ever managed before under Community Development Block Grant or HOME or anyone else. There isn’t an infrastructure in place to manage the volume of federal dollars that are available and that are under fairly strict compliance laws.

And that's coming at time when state and local governments are under incredible stress. As we read in the paper every day, states, counties, localities are cutting back on personnel at the very time when they're being asked to implement more programs. One of the impacts of that is that most communities are keeping every penny of administrative money that is available under NSP and really don't have any left to pass on to some of the nonprofits and even for-profits and other entities that are implementing the program on the ground.

Another thing that's being felt as an operational constraint is that NSP is a reimbursement program. So, if you need to show up at closing to buy an REO property, you don't have the cash in hand from NSP to be able to go and buy it with NSP dollars. As communities are getting further into implementation, they're recognizing that they need sources of capital, bridge loans, whatever to be able to buy the property, then get reimbursed from NSP, rehab the property, then get reimbursed from NSP. As we move through the cycle of implementing the program, we're beginning to see the need to bring capital to the table.

At the same time that NSP has been slower to implement than we expected, there's also been an interesting corollary in the flow of new REO onto the market. We just spent the last half-hour or so taking about Making Home Affordable. Something I didn't really anticipate and that has happened is there was a real slowing of bringing properties to completion of foreclosure as servicers stepped back wholesale and looked at all the borrowers on which they had commenced foreclosure proceedings to see if they were eligible for the Making Home Affordable Program.

Now, that's a great thing. That's a good thing. But what it's meant is that the REO pipeline is really backed up. What we hear from the servicers we talk to is that there's a big balloon working its way through the system, and that probably sometime later this summer, early fall, we're really going to see a big increase in the amount of REO property that will show up on the marketplace.

This is all happening in a context that Chairman Bernanke mentioned in his speech about CDFIs and community development organizations yesterday. These are the very organizations that we most want to step up and be involved in stabilizing our neighborhoods, but it's coming at a time when those organizations are also under a great deal of stress. Links back to CRA -- that a lot of the banks that have supported those organizations are not able to make as large an investment this year in their CRA program as they are managing their balance sheets. It's a time when a lot is needed and the capacity is probably at its lowest point in many years.

A couple of other comments. Right now NSP2, which was the $2 billion of additional funds allocated in February, is out for competitive applications. Those are due in mid-July, and we expect to see those dollars come probably right before the end of the year.

We do see a lot of communities really stepping up, putting together collaborative applications. Someone asked me yesterday, do we really think that the impact of NSP2 will be stronger than NSP1. I tend to be an optimist, but I really do think because people now have a sense of what they need to do and how big the problem is that NSP2 will see some different and more focused structures.

Another piece that we didn't talk about yesterday but I think is critically important -- HUD announced in early May notice of funding availability for technical assistance for both NSP1 and NSP2. Those applications were due the 8th of June. I really hope that HUD will move very, very quickly to award those contracts because there is a desperate need for technical assistance for nonprofits, for the communities, and really helping people put together competent programs that make the most of the dollars that are available.

I'll close just very quickly. Last time I talked about the National Community Stabilization Trust, which is a joint venture of six of the country's largest national nonprofit community development organizations that is working to provide a platform for the exchange of properties between servicers and communities. I'm pleased to say that we're continuing our implementation.

We currently have about thirty communities that are what we call live with the trust, meaning they're beginning to see property listings from the servicers and beginning to be in a position to buy properties. We've actually had about 175 properties that have been accepted, the price has been accepted and they're either closed or moving towards closing, with many more in the pipeline now.

I wanted to also recap the servicers that we do have on board: Bank of America, JPMorgan Chase, Citibank, GMAC, Saxon, Wells Fargo, Freddie Mac, and Nationstar. One of the things as we get into working with individual communities where lending patterns may have been very different from other communities, we're finding that we desperately need to get Fannie Mae and FHA to the table. Because places like Memphis, if we don't have FHA at the table, we miss about half the properties in that community. It really varies a lot from place to place.

Just a final comment that the Stabilization Trust is engaged in conversations with about 150 communities around the country. They'll come on board at differing paces, but it's fairly different from where we started out where we thought, gee, we'd be really successful if we were in twenty-five or thirty places. We recognize just how widespread this issue is and felt we needed to reach out to a lot more places.

So, with that, I'll hand it back to Patty.

MS. HASSON: Okay. Thank you, Mary. I'm going to turn it to Lorenzo to talk a little bit about his experience.

MR. LITTLES: Well, I'm going to give you the micro-view of this. We have submitted three proposals to the Texas Department of Housing and Community Affairs under NSP1. One, to expand a down-payment assistance program to nine counties and five cities that surround Dallas and Tarrant County.

One, to provide acquisition and rehab consultation. We have over the last two and half years been involved in HUD's Asset Control Area Program. We acquired and rehabbed 199 properties, and we've sold 181 of those. We do have some extensive experience. What we think is critically important is that the compliance side of the acquisition-rehab piece of NSP is going to be the one that gets people in trouble. It is not as complicated to -- there will be some problems in terms of capital available for acquiring properties, but most people know how to rehab them if they've been in that business. The issue is whether you will be able to get through all the paperwork that will be required from HUD in compliance with NSP1.

And finally, we applied to the city of Dallas for its acquisition and rehab program, and we are working with a for-profit partner who will bring the capital to the table for the acquisition and actually the hold the properties. We have eighteen properties remaining from our purchase, and our senior management will not let us acquire and hold more properties because it's really the holding cost in this market that is eating us alive.

I have just three observations. The first is that eighteen-month implementation time frame really forced a lot of political jurisdictions to take the path of least resistance. That is, in order to meet the statutory requirement, a lot of the PJs are going to land banking, property demolition. They're doing modest acquisition and rehab programs, or they're doing down-payment and closing-cost assistance programs because that will facilitate getting the money out within the eighteen-month time frame.

As Mary just said, because the political jurisdictions are also strapped, for the most part, my observation is that they have taken the administrative money that was available in the act and kept it to maintain their own operations, and the balance of the money has been put out to bid for the for profits and nonprofits. We've run some numbers, and it does not appear that it is going to be financially feasible to successfully do an acquisition-rehab program, at least within the city of Dallas. But hopefully we can make it work.

And finally, I think that the challenge that we've talking about since the crisis hit -- that is, the change in the ability of low- and moderate-income families to purchase properties -- is, I think, a key factor in how NSP1 will be viewed when we look back on it. From June of last year in our mortgage assistance program, we were getting families into homes with credit scores of about 580. In June of this year, those same families -- no difference in their employment situation or anything else -- need between 620 and 650 to get into homes. I think it's going to be a challenge to find purchasers for the homes that are acquired and rehabbed. At the end of this process, we're going to end up with rehabbed homes and renters, and that scattered-site rental is a very difficult program to manage.

Thank you.

MS. HASSON: Okay. Thank you. Greta, do you want to add to this conversation?

MS. HARRIS: I would ditto almost everything that Lorenzo said on the pragmatic, implementation side of things with what we're seeing across the country. Additionally, the way the program is being implemented -- that the hardest-hit neighborhoods, inner-city, concentrated-foreclosure communities are probably not being the recipient of a lot of the NSP resources right now because it just doesn't pencil out to the benefit of those communities.

I want to elaborate on a couple of items that Mary mentioned. There are very creative and robust collaborative -- public, private, and community collaboratives -- across the country that are trying to take full advantage of the NSP program.

They are generally led by community development organizations that have a long and connected history to many of these communities. They've been working in them for one, two, three decades and are really just completely dismayed at the quick deterioration of neighborhoods that had made so much progress and were turning the corner for the better. But nonetheless, they're committed to rolling up their sleeves and trying to fight the good fight to help the neighborhood. I think their strategy, of course, is to help stabilize and then to slowly put building blocks in place in order to be a catalyst to rebuild the neighborhood economic engines again.

One of the challenges with the NSP program is that it is a reimbursement one, and so as Lorenzo and Mary said -- acquisition, construction, holding costs, and also marketing costs to try to attract people to come into neighborhoods. You go into parts of St. Paul and drive through and every other house has a blue placard that says that a foreclosure has happened. It's not the most attractive thing when you're trying to bring new homeowners into the community. All of those costs are there, and it's on a reimbursement basis.

Across the board, we've seen our community development partners lose their lines of credit from their traditional financial institutional partners, and so there is a great need for access to capital. There are CDFIs across the country who by the nature of our mission are prepared to go in there and do the high-risk underwriting both from a community market perspective as we're seeing values decline as well as the deterioration of the financial condition of the borrowers. But nonetheless, we are prepared to provide access to capital in a meaningful way to help implement programs like NSP and others to help these communities get better.

But our access to capital has become challenged, and I think there are two main reasons for that. One is the loan repayment from the existing portfolio of partners that we have across the country. Over the last six months, in particular, there has been a dramatic slowdown in repayments. The replenishment of our capital pools that we traditionally have counted on have just dried up. As partners where they can't get equity for tax-credit deals or there are gaps because of valuation drops now, public-sector subsidies are being raided by general assemblies to fill state funding budgetary gaps. They just don't have the resources to repay that. That's one main source of a reduction in our available capital.

And then secondly, our traditional lending partners, whether it be financial services institutions or national foundations, have lessened their appetite for large-scale lending at this point. Especially with the financial services institutions that have been the beneficiary of some of the recovery resources that have come in, CDFIs that are on the ground prepared to lend in these markets have not had the parallel benefit of those types of resources coming in to recapitalize us so that we can help jump-start these neighborhood economic engines going again.

We would welcome the opportunity to try to figure out how the CDFIs could be better capitalized to help move this agenda forward.

MS. HASSON: Thank you very much. Kevin, did you want to comment on the interactions with the city and the mechanical --

MR. RHEIN: Yes, yesterday, we chatted and then Mary and I talked a little bit. One of the challenges from the servicer perspective is we very much believe in the whole neighborhood trust process, but it gets hung up in the negotiating with the individual cities through the neighborhood trust. We have a master agreement that we're very comfortable with the neighborhood stabilization trust, but then they have to go back and forth to the different cities. As you get attorneys involved, attorneys are looking for ways that they can say, well, you ought to change this, you ought that, and it just elongates the process.

I don't know if there's any way to try to streamline that and, Mary, maybe you want to opine in this area. There's a funding issue, but then there's also the negotiation. The negotiation is sometimes getting protracted because different people are changing things that really aren't adding that much material benefit. It's just sort of part of the job and part of the process. So, I don't know if you'd like to --

MS. TINGERTHAL: Just a quick comment on that. What we're finding is that communities are really not very experienced at acquiring REO property, and acquiring REO property is a very specific art. The typical way that an REO property is transmitted by the seller is with an REO rider which says you take the property as it as to condition and as to title. That doesn't work particularly well when you're trying to rehabilitate the neighborhood and when you're paying not 10 cents on the dollar, but probably more like 50 or 60 cents on the dollars.

What the Stabilization Trust has tried to do is to develop a standard purchase agreement, but as we all know, real estate law within this country allows for only a certain degree of standardization and you must take into account state and local law in really taking it down to the property-by-property level.

We're working very hard to put those standard agreements in place in the thirty and hopefully up to 150 places we'll be in, but that's proven to be a fairly expensive proposition. It's valued once we get it in place by both the buyers and the sellers, but we're essentially providing that technical assistance without any kind of reimbursement. So, it's something that we've recognized. We've kind of picked up the task, but it is indeed challenging from both a legal and a financial standpoint.

MS. HASSON: Okay. We have a couple of minutes left, so we're just going to quickly touch on rent within neighborhood stabilization -- Greta.

MS. HARRIS: Are you saying rent?

MS. HASSON: Rent. Sorry.

MS. HARRIS: Okay. Okay. I really just wanted to just make a point about trying to shore up the delivery system for trying to make this program viable.

The community development organizations that are on the ground that are trying to move this agenda forward are really in need of two things. One is some capacity-building support in helping them to reposition for a future, a new paradigm of what the community development field is going to look like going forward. A production model that we used to count on as a revenue stream to help sustain our organizations in carrying forward work no longer looks like in the short term that it's going to be available to us. I think the capacity-building resources to help them reposition to continue to be agents of change at the neighborhood level is important.

Additionally, I think that there is some cautionary tale to our nonprofit partners. At least, we're offering that advice about taking on large quantities of these troubled properties. If large financial institutions are having difficulty holding onto them, an undercapitalized nonprofit organization will have trouble as well.

We're concerned about, as Lorenzo mentioned, not being able to have a homeownership sales market available for many of the communities around the country. The CDCs having the capacity to manage scattered-site rental properties is going to be a challenge for them going forward.

MS. HASSON: Okay. And one final note from Kathleen because there's always a Cleveland story, unfortunately for Cleveland.

MS. ENGEL: Well, maybe Governor Duke can talk about Cleveland because she just took a little tour last week.

Actually, my story isn't just about Cleveland. Because yesterday I told this as a Cleveland story and last night, I did a little looking around on the web and it turns out it's happening now in other parts of the country. The story is that with all of these vacant homes, some of which are abandoned, pseudo-landlords are going in and changing the locks and renting the property out. Borrowers pay first and last month's rent and a security deposit, and then a few weeks later get evicted for squatting in somebody else's home.

It's happening both where people take possession but also, I was reading, in Florida sometimes the people don't even get possession. They pay the first and last month's rent and the security deposit, and then the alleged landlord says we'll meet you there Saturday the 1st and hand over the keys. Then they don't show up and, of course, the checks have been cashed. I think that we just need to be aware that there are all of these trickle-down negative consequences of so much abandoned and vacant property in our neighborhoods.

MS. HASSON: Okay. According to that clock, I have one more minute and Kirsten's asked for it, so I'm going to hand it to her.

MS. KEEFE: I just wanted to note that the Protecting Tenants at Foreclosure Act of 2009, which provides tenants a 90-day notice, is wonderful, and we're thrilled that that was passed. However, it's written vaguely, and there is some question about its application with different states laws.

So, I just wanted to get that on the record that further guidance to clarify that New York is having a problem with it. I know Minnesota is as well.

MS. BRAUNSTEIN: We've received some correspondence about that.

MS. KEEFE: Great.

MS. HASSON: Okay. Lorenzo.

MR. LITTLES: I just wanted to end on what I hope is a more positive note. After I listened to this again, I thought to myself, well, why are we doing all this? But the truth is what I come away with is that some policy decisions were made in an attempt to address what is a much more systemic and challenging problem than any of us imagined.

I think it's going to take longer for both NSP1 and NSP2 to get traction and to begin to work, but I do think that we are moving in the right direction. I hope that none of us gets discouraged by the fact that there are these significant challenges as we go forward.

MS. HASSON: And with that, I'll turn it back to you, Edna. Well said.

MS. SAWADY: Thanks. Well, thanks, Lorenzo. It's really nice to end a discussion on a good note.

As I was listening to all the discussions, just wanted to acknowledge the huge amount of work that it takes to get us all here and for us to really be able to engage in such productive discussions and all of the Board staff has been extremely helpful in preparing for it. Especially wanted to acknowledge Joseph Firschein and Jennifer Kerslake for their huge amounts of work, both quality and quantity, and their focus and expertise that brought us here.

Okay. Committee reports, and we'll have a little bit of change, I think. We started it last time. I'm going to call on committee chairs to briefly share with the group what their committees have been discussing that has not been covered in today's agenda.

So, first is the Housing and Community Development Committee. Patty, we haven't heard from you for a while.

MS. HASSON: We covered it all.

MS. SAWADY: Okay. Well, do you have any --

MS. HASSON: I have no additional comments.

MS. SAWADY: Oh, you were lucky.

MS. HASSON: Thank you.

MS. SAWADY: Okay. So, you were lucky. We covered everything today. That's why you had such a long streak of leadership roles.

Consumer Credit Committee, Tom.

MR. JAMES: Yes, we covered most of it. We did have a presentation that Jason arranged for us that was, I thought, very compelling surrounding credit scoring. I think in many ways credit scoring played a large role in the collapse of things the way we knew them before, and credit scoring's going to continue to be fundamental to policymaking as we move forward. We got a taste of some of the science of it and some of the art of it yesterday, and I hope that we'll have more focus on that in the future.

I would highly commend reading the material that was provided to us. I found some of it quite fascinating, actually. I've been working in this area or in areas that were addressed for the last ten years and there was some stunning news buried there. I hope we'll revisit the world of credit scoring in the near future.

MS. SAWADY: Thanks. Depository and Delivery Systems, Kevin.

MR. RHEIN: Yes, I think we covered it. It was really the prepaid products -- disposable, reloadable -- and then as I mentioned Jennifer's presentation on the segmentation. So, that's essentially what we covered.

MS. SAWADY: Great. Well, other than the three committees, we've also started this year with a new committee that is the Special Issues Working Group. Not really a committee, more a working group that has subgroups working in it. Mike.

MR. CALHOUN: Just very briefly, as the members of CAC know, this is a new experiment for this year. The idea was to allow discussion of additional topics that aren't necessarily within the purview of one of the standing committees and to provide opportunity, since all of us have spare time on our schedule, for work to be done in between some of the CAC meetings.

So, we've decided to set up subgroups. We have three of those right now. The first is Kathleen Engel and Saurabh Narain are heading up the subgroup that's looking at data issues. Kathleen, I think, alluded to this earlier in our discussions today. The types of data that are collected and some specific areas where additional data might be very useful.

Ira (Goldstein) is heading up a subgroup on CRA. Finally, Ron Phillips -- who I think had to leave -- is heading up a subgroup on small business lending. We look forward to working and producing some deliverables with that between now and our next CAC meeting.

MS. SAWADY: Thanks. Well, I think we got to the end. Now we can adjourn. Thanks to everyone for participating. For the Council members, lunch will be served in Dining Room L just down the hall.

The next set of dates for 2010 -- March 24th, and the public meeting is the 25th. March 24th to 25th is the first session. June 16-17, with the public session on June 17. October 20th and 21st, with the public meeting being on the 21st.

Thanks to everyone.

(Whereupon, the meeting was concluded at 12:21 p.m.)