TRANSCRIPT OF THE FEDERAL RESERVE SYSTEM
CONSUMER ADVISORY COUNCIL
THURSDAY, OCTOBER 22, 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
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
Saurabh Narain
Andy Navarrete
Jim Park
Ronald Phillips
Kevin Rhein
Shanna Smith
H. Cooke Sunoo
Jennifer Tescher
Stergios "Terry" Theologides
Mary Tingerthal
Luz Urrutia

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

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9:03 a.m.

MS. SAWADY: Good morning, everyone. I'd like to open the meeting by welcoming everyone. Before we begin, I'd like to take a minute to acknowledge the Governors in the room and thank them for their ongoing support – Chairman Bernanke, Governor Betsy Duke, and I understand that Governor Daniel Tarullo may be with us in a little while.

I'd also like to acknowledge that this is the final Council meeting for ten of our members, including myself. We have greatly benefitted from everybody's input, and I know I will miss all my colleagues and the workings of the Council, and I'd like to acknowledge everybody's contribution at this point. As I call the names, anybody who wants to make a brief comment or remark is welcome to do so. Jason Engel from Experian.

MR. ENGEL: You promised brief, but I guess, since I go first, I get to be the first to remark that it's been an incredible three years -- interesting, I guess, in the sense of the curse. I wanted to thank my colleagues. I owe a debt to everyone here and the breadth of knowledge that they bring, and the Board staff as well for their excellent help in all of our work.

MS. SAWADY: Thanks, Jason. Now I'd like to thank one member. All the members are always very forthcoming with ideas, and we have one person whom we have not heard from quite a bit during all this time. Joe Falk.

MR. RHEIN: You don't need a mic, Joe.

MR. FALK: Well, I appreciate the privilege and the honor of being with all of you. I especially have enjoyed building relationships with staff and the other members of this esteemed body. It's been a great pleasure to debate and contrast views with all of you, and I'll miss all of you. Thank you.

MS. SAWADY: Thanks. Louise Gissendaner.

MS. GISSENDANER: I also would like to say that this has been absolutely an invigorating experience and, actually, oftentimes very challenging. I am just really excited about now being an alum.

MS. SAWADY: And Louise is from Fifth Third Bank. Patty Hasson, Consumer Credit Counseling Service of Delaware Valley.

MS. HASSON: Thank you. I too would like to thank the Board staff and the Governors for this opportunity. It really has been a great experience. The one thing I will not miss is two terms. One is “unintended consequences.” I have to leave saying there are always consequences, and so doing nothing sometimes has its own consequences.

And I know Kevin knows my second, which is “anecdote.” I had to look up why I didn't like the word so much, and it's actually humorous throughout it. I think that the stories a lot of the consumer people tell -- they're not anecdotes, they're not humorous. So I wanted to leave that thought with all of you so that in the future you think about that because I know some of my colleagues here will use some anecdotes, and they aren't anecdotes. They're really, truly people stories.

MS. SAWADY: Great, thanks. Tom James, Office of the Illinois Attorney General.

MR. JAMES: Well, this was certainly one interesting three-year period to be here especially. I want to thank the Board and particularly the staff. I am wowed by the tremendous resource that's here. It's a great thing for the country. Those of us who come out from the interior, the provinces, bring back our impressions, and it's very important to know that we have such a depth of richness here, and so I thank you for the experience. It's been absolutely fantastic.

MS. SAWADY: Cooke Sunoo, Asian Pacific Islander Small Business Program.

MR. SUNOO: From Los Angeles. It's a very interesting body, and it's a tremendous honor to be here. To think that we have had consistently over the last three years -- we've had the consistent presence of the Chairman at our Thursday morning meetings as well as other Governors underscores the importance with which the Fed takes on our input.

Chairman Bernanke, I don't know if you recall, but early on I had asked the question that, with such disparate interests around the table, does this group ever reach consensus. You said, "You know, I hope you don't," and you said, "I hope you don't, because if you did, it would diminish the level of input that the Governors would be hearing."

And what you suggested to me at that time was that what's so important to the Fed is the level of dialogue between the members and to hear the different points of view, and I think clearly this body has done that over the years that I've been here, and I know that we will continue to do that. It's by our nature.

One last point is that over the last year we have put on the table more and more the idea that small businesses are consumers also and that as a Consumer Advisory Council it's important. I believe it's important that we keep small businesses on the agenda as well as individual consumers, so thank you for the opportunity.

MS. SAWADY: Terry. Terry Theologides, Saxon Mortgage.

MR. THEOLOGIDES: Thank you. I too agree that it's just been an honor to serve on this Council, and I've been continually impressed and humbled by the dedication of the staff and their expertise as well as the commitment of my fellow Council members.

Over the last three years, for obvious reasons, we've spent a lot of time on discussing various ways to enhance consumer protections. I think that's been the focus of a lot of the rule-making and what's happening for obvious reasons. I hope for those of you that are remaining on the Council that we reach a point where people feel good enough about the guardrails that the discussion can start to also turn toward how, within that construct, fair and informed access to credit can be provided to really serve as an engine for economic growth. Hopefully, we reach that point soon.

MS. SAWADY: Luz Urrutia, El Banco de Nuestra Comunidad.

MS. URRUTIA: Great pronunciation. Well, thank you, everybody. I have to say that this is probably one of the brightest, smartest, most exceptional group of people that I have ever had the pleasure to be associated with. One of the things that always strikes me about these meetings is how much passion there is. Whether they come from the consumer side or from the industry side, there's obviously a very sincere caring for what each and every one of you all do.

I certainly have gotten more out of this group than I have contributed, and forever I will be thankful and honored to have been associated with each and every one of you. Thank you very much.

MS. SAWADY: Thanks. Linda Tinney from U.S. Bank could not be with us today, and she's also part of the departing class. So am I, so on a very personal note, I wanted to just say it has been an incredible experience for me, especially at the time of so many structural changes in the industry and knowing that we have made some contribution to a lot of what's going on.

Okay. Ready? Ready to dive into the meat of the agenda. First on the agenda is closed-end mortgages and home-equity lines of credit.

On July 23 of this year, the Board proposed changes to the disclosures that consumers receive in connection with closed-end mortgage loans or home-equity lines of credit, also known in the industry as HELOCs. The goal is to improve both the content and the format of these disclosures to make them more useful to consumers.

Many of the changes proposed for the disclosures are based on a lot of consumer testing. We had a nice discussion yesterday and a nice presentation about consumer testing, so we all know how much is going into that.

Yesterday, the Council discussed the proposed new requirements and the proposed changes to the disclosures as well as other consumer protections that are in the proposal. So I'd like to at this point turn it to Patty Hasson, Chair of the Housing and Community Development Committee. Patty, if you can take us through the discussion.

MS. HASSON: Okay. Thank you, Edna. For the Council, we're going to break it up into three sections. We're going to talk about the closed-end. Then we'll go to the HELOCs, and then we'll move on to compensation.

So if you can kind of keep it in that realm, we'll start off with the closed-end disclosures. I just want to also point out that it was very easy to chair this yesterday, because the disclosures were so well done. I think that we can say in unison everyone was impressed by the work that has been done by the Board staff on these disclosures. It almost started out somewhat slow, because everyone was spending a lot of time complimenting them. But, as usual, discussion ensued, so I think we can go to that discussion. Kevin, I'm sure, on the --

MR. RHEIN: Sure, I am happy to start off. Again, I would like to applaud the staff. I thought it was excellent research on the disclosures. To Patty's point, everybody, I think, felt good – there were little nuances but generally extremely good.

A couple quick things I'd like to mention -- the idea of the APR calculations. We talked a little bit about what gets included in that APR calculation. We were a little concerned about things like some of the settlement costs, if escrows start to get included into that calculation, things like mortgage recording taxes, things that are completely outside the lender's control. That can start to drive up the APR. If the APR gets driven up, then you start to potentially get loans into a high-cost category, and lenders in general are trying to do a lot less of that. So we wouldn't want to have items included in that APR calculation that are really distorting it and might cause a contraction of credit because it would trigger it being a high-cost loan.

We talked a little bit about the graph and where the rate shows on the graph, that that's very problematic from a systems perspective. I don't know enough about it to be dangerous from a programming perspective, but our tech people tell us that's very difficult to do. If there is another way to maybe think about displaying that same sort of information, not necessarily graphically, we would encourage the staff to take a look at that.

There was some discussion about the three-day disclosures, having to get the final disclosure within three days of the closing and whether there should be a threshold for when you would have to do that final disclosure. We would encourage that there should be some sort of threshold, if there is only a $50 change for some third-party cost or something. Consumers are already extremely overwhelmed by the amount of information they get, so let's make sure that that final disclosure of costs is meaningful.

The three-day standard worries us a little bit. In many cases, there are closings where it's down to the last minute, and there are a series of transactions lined up behind one closing, leads to another closing, leads to another, moving vans, everything there. So if there is a three-day standard, is there some flexibility around that so a consumer could waive that three-day standard so the closing could still go through? Those would be the main points.

MS. HASSON: Patricia?

MS. GARCIA DUARTE: Good morning, everyone. I just want to share that I believe the three-day disclosure before the closing is really crucial and important, because this represents for many people their most major investment in their life. Too many closings have happened with people going to the closing table and being surprised by different charges, so the three-day notification is really crucial, and it's important.

I think this is an opportunity for the industry to perfect the work, get the numbers right early, and that will avoid surprises at the end. Many times, the morning of the closing all these new surprises arise. I understand that it's a big change, and industry may be nervous about it, but it's a good thing for the consumer. I think that the consumer having this time in advance to really better understand what all the numbers are is really a good thing.

The waiving of the three-day notification concerns me a little bit, because it'll be very easy to just get everyone to waive that to get to that closing. Everybody is emotionally involved and wants to get those moving vans going, but separating the emotion, I think it's very crucial that that three-day is provided and that all the numbers are done early. I think it's doable. Thank you.

MS. HASSON: Kathleen?

MS. ENGEL: Thank you. I think that I feel sympathetic to the arguments of industry that having a rigid three-day rule with no waivers and no safe harbors or anything like that can put a lot of pressure on them to make sure that they get all their ducks in a row three days prior to closing. But I think those costs have to be balanced against what we've learned about consumers' experiences at closing, which is that they can feel very pressured when they're in the closing situation to accept things that are thrust upon them at that point. For that reason alone, I think that the arguments weigh heavily in favor of a rigid three-day-in-advance rule, so we don't end up in that situation.

The second thing is this rule isn't a rule that says, "If all your ducks are in a row, you can close if you've given the three-day notice, and if there are errors, you can't close." All it means is that the lender is going to have a problem at the closing if they didn't give the proper disclosures or accurate disclosures, but that doesn't mean it can't go through. It can still go through. If there is an extra $50 charge or something that's tacked on, then that's something just that the lender can absorb, because they didn't get everything together three days ahead of time. It shouldn't hold up the whole closing.

And the third thing is we talked yesterday about the spillover effects if a closing doesn't go through -- you know, the moving van outside the door. Maybe a property sale doesn't go through, and then there's another property sale that hinged on that financing, and so it goes.

Those are real risks, and I think because of those real risks, having this rule will create incentives for the lenders to do a really good job. If I had some home sale fall through because somebody else's lender didn't get the disclosures right, I'm going to find out who that lender was and make sure that I never use that lender and nobody I love uses that lender. So it seems that these are small problems that just can be fixed by being thorough 72 hours earlier.

MS. HASSON: Any -- oh, Mike. Sorry.

MR. CALHOUN: First, I want to join in the praise of the staff for their work on this and in particular for the consumer testing that they did. I think we need to recognize the difficulty of this task. Mortgages are inherently complex transactions. There are people at the table who have interest in closing it as fast as possible, and there are people often involved who have interest in obscuring some of the features of the transaction.

I think the Fed is uniquely positioned, though, to take testing to another level, and I want to encourage that. We at [the Center for Responsible Lending] have looked at options in this regard, and Shanna is one of the experts on testing here, but in the mortgage area there are substantial cost and compliance obstacles for a private entity to do real testing.

First, it's very expensive to go through it, and there are legal obstacles. You cannot present false data. You cannot do a dummy transaction. If you go through the transaction and don't provide accurate data such as using actors -- we've investigated this -- you're violating federal banking fraud provisions. It's very expensive for a customer to actually go through and close a transaction that they don't really want it as a testing procedure.

In our experience, I think, from a lot of consumer advocates is a lot of the bad practices happen at the closing table. People are presented with the bait-and-switch and the pressure to close. It's very hard to accurately measure that, though, without this kind of difficult testing. So we would encourage that type of testing and more interviews of real customers after the fact.

The work that's been done in that area to date suggests that customers have very little understanding. For example, there have been some testing you all have done of understanding of interest rate risk, and it confirms what we find in informal conversations. People think that if their interest rate goes from 7 percent to 9 percent that that means that their payment may increase by 2 percent. That's not an uncommon understanding out there.

So we would encourage lots more testing there. As I said to someone, I like to sail, and in the sailing world they say a bad compass is worse than no compass. I think that's important when you look at most of the data we have now, and this isn't just to the Fed but also the Federal Trade

Commission, it's generated from an extremely artificial environment where people are provided disclosures and said, "Now, focus on these, and see what you understand, and take time and read them." That's unlike any closing that I think anybody goes through. I want to acknowledge again that it's very, very difficult to get that real-life experience, but I think the Fed truly is uniquely positioned to gather that type of data, and we would encourage it.

Just real quickly, two last points. We strongly support the all-in of fees. I think that's more simplification. People shouldn't be arguing about what [Regulation Z §226.4(c)(7)] fees are and what gets excluded as much as they do, but legally everything in the APR we strongly encourage to make that a more useful number.

We also encourage that fees be amortized over a realistic period. When the APR is calculated today, fees are amortized over the stated term of the loan, usually 30 years, which greatly understates their actual cost to the consumer. Since most loans are refinanced in a five- to seven-year period, the fees should be, we believe, amortized over that period or the actual term, whichever is less.

Then, finally, to follow up with Kathleen's point, having the requirement that accurate disclosures be given three days prior to closing is critical. Making it a condition of closing is what will drive compliance. We have existing rules on the books today regarding the HUD-1. Anybody who practices in that field finds that it is truly the exception for those rules to, in fact, be met because there is no consequence of either legal liability or stopping a closing when you don't provide a HUD-1 in compliance with existing law.

MS. HASSON: Okay. Tom?

MR. JAMES: I just want to second that, having taken apart many thousands of transactions and recovered close to $100 million in restitution with a group of attorneys general pursuing lenders who uniformly gave inaccurate disclosures prior to closing and presented bait-and-switch at closing.

There is no substitute for accuracy, particularly in the early disclosures -- that's a person's first impression. That's the impression that sticks and for those disclosures to remain consistent and almost absolutely, if not absolutely, consistent, right to the closing table. If there are changes, those changes should be made well in advance with plenty of warning and notice.

MS. HASSON: Joe?

MR. FALK: Enforcement and penalties for bad behavior. In the 1,200 pages that I read of this proposed rule, I would like to see more pages and more words around how regulators can enforce these rules, give consumers an ability for redress in some manner, and also penalties for bad behavior.

It's pretty well known in the industry that if there are mistakes or problems or issues, the consumer can scream at the closing table, but there is no practical relief short of rescission, which is very limited, in trying to either sue a loan originator or seek redress from the loan originator or a loan origination company or an institution. The facts are that if the documents are not correct, there is little or no penalty for bad behavior, and I hope that the next phase of rulemaking would increase that requirement for industry to be accurate.

MS. HASSON: Alan?

MR. CAMERON: Thanks. We in the lender community, I think, agree 100 percent that there ought to be accurate disclosures, and the earlier those disclosures are given, the better. I think the alternative that allows for a minor tolerance, a de minimis tolerance, does just that.

The disclosures given within three days after application should be accurate. We're suggesting that the alternative that allows for just minor errors, minor changes, things that come up at closing that happen so frequently that could stop the transaction -- could stop, as we've said, the moving van -- are not things that should impede the flow of commerce.

So we're not arguing at all in terms of the need for accuracy. We're talking only in terms of the importance of the differences between the final numbers and the numbers given in the initial disclosure. So I would think that a de minimis rule is a fair rule, and a waiver rule would be a fair rule, so we would suggest that second alternative.

MS. HASSON: Luz?

MS. URRUTIA: Educating the consumer is the best place to begin to correct the problem. I think all applicants that are seeking to get a loan ought to be required to attend a government-sponsored seminar to understand what they're about to get into, similar to senior citizens being required to attend a government-sponsored seminar if they want to obtain a reverse mortgage, and perhaps they can get a fee charged for that that could be a tax credit if they attend in their tax returns the next year. But education -- the consumer needs to take ownership as well for understanding what they're about to embark upon.

MS. HASSON: Terry and then Edna?

MR. THEOLOGIDES: Thanks. One other observation I had was that as more fees are being encompassed into the APR calculation, some of the third-party fees, it appears that more loans will be captured into the higher-cost and high-cost thresholds either of federal or state laws or regulations. Those thresholds were set, I think, with thought and with comment and everything. And if the intention is to encompass a greater body of loans in those protections and that's the product of that thought and you're soliciting comment, that's all right. If it's merely kind of an arithmetical byproduct of adding these additional fees, then I'd suggest revisiting where those levels are and where the additional protections ought to reside. Thanks.

MS. SAWADY: We had a really lively discussion yesterday about the three days. I think it took quite a bit of the time as we talked about it, and sitting back I'm just thinking there are different levels at which the three days really were intended or four different things they were intended to cure. The first two being bait-and-switch, just outright fraudulent activity, and the other one, fairly far removed from that but very important, is the consumer understanding and consumer education.

On those two levels, I would suggest a zero tolerance. We need the three days with no waivers, no ability to do anything. Just give the three days. Make sure that the consumer well appreciates everything that they are going to sign on such a huge transaction, and there is no room for bait-and-switch or any other fraudulent activity whatsoever.

The other two that I mentioned are lender errors, which may happen, and for that there were a lot of suggestions made that the lender should really be responsible for those errors if they originate from the lender's side. And then, lastly, and we've taken a lot of time to talk about it, but it doesn't happen very often, but there are those last-minute things that should not get in the way. You know, the fridge breaks down. That's $300 that the seller of the house is going to compensate half of it to the buyer. These things should have some way of not stopping the transaction. So my suggestion is just to look at the four different dimensions under it, and the solution may not be the same for each one.

MS. HASSON: Okay. Cooke?

MR. SUNOO: All of the comments are really very important, and the closing of a transaction such as this is very complex. That is in the English language. If you happen to be an immigrant whose first language is not English, or if you are not proficient in English, it becomes exceedingly more complex, if not impossible, to understand.

So, as we are a country growing in terms of our immigrant population and not just immigrants but the diversity of immigrants coming in, it really becomes exceedingly important that included in all of this is a plan of how we are going to communicate this very complex, very important information to a more and more diverse community of immigrants.

It's not just Spanish. It's not just the Asian languages. It's the other parts of the world where people are coming to take part in the American dream. Thank you.

MS. HASSON: Ron?

MR. PHILLIPS: We're an alternative lender as a CDFI and not regulated. We don't want to get any ideas we should be, particularly under these things, but we are active making loans every day. I can't think of one instance in our lending that we would ever not have disclosed and had the customer aware fully and completely of what the costs are at closing.

As a cost of business, if we've made a mistake or there is something that jumps up at us toward the end, it's a cost of business on our end that we absorb. Now, frankly, we have a mission as an alternative lender, and so that's our job, but I just wanted to say that. Thank you.

MS. HASSON: Kevin?

MR. RHEIN: Yes, just a couple of quick comments. Mike, on the APR calculation, you've mentioned a couple of times how do you truncate the term and look at almost a half-life or something like that. I would just say that's extremely difficult. If a loan is a 30-year loan, the effect of what you're doing -- maybe it's desired -- is it would again drive up the APR if it's over a shorter period of time. I think that's part of your point, but that also has the implication of making it a higher-priced loan.

Everything we start to do that causes more loans to get into that classification could be a detriment to people being willing to offer it. I think APR calculations are APR calculations just based on the contractual term of the loan, so we would not be in favor of truncating that term.

I'm assuming when you talk about fees -- escrow amounts, taxes, insurance, would you include that, that you would consider that a fee? Okay, so I think we have agreement that those would not be part of the APR.

Two other things. There's been a tremendous amount of work mortgage companies have been doing to get our Good Faith Estimate form lined up with some of the other requirements. We spent supposedly 14 months getting ready for requirements that are required under HUD, I believe it is. To the extent that you're going to revise the final Truth in Lending document, how do you maybe consider what's already been done, all the work that organizations have done to get ready for the requirements under that Good Faith Estimate and try to mirror those things up? Otherwise, you're back into a very large development effort.

And the last comment just is the time. Any time you're doing something that has an APR calculation to it, it's pulling information from multiple different systems. This stuff doesn't happen overnight, so whatever rules you come out with, we certainly need a significant amount of lead time to be able to comply with them. Thank you.

MS. HASSON: Okay. Any other comments? I guess my two concerns are, one, as I see these disclosures, and I mentioned it yesterday, some type of testing to really walk somebody through this process. This is a lot of information and a lot of different disclosures. While each one individually looks fine, until the individual goes through this transaction and you test whether or not it really works for them in the real world. I would love to see either a pilot of this with a bank, which would be a little bit different, I know, or some type of testing mechanism where you really look at the real world and try and pull a bait-and-switch and see if you can do that to a consumer using these forms.

And the second piece, which I noticed it on the forms after yesterday's meeting, is, again, being in a consumer's mind, if you're sitting there and it's three days before the closing that you get this, and it's totally different, and you're upset and thinking, "Well, what do I do?" Going to a government website is one great suggestion.

Going to a housing counselor if you're not at that point, or even if you are, making sure that the forms say, "Go back to your housing counselor if you have concerns, or if you don't have one, contact a housing counselor if something doesn't appear the same," because many people don't always use housing counselors. So just another thought.

With that, I guess we can move into HELOCs and the disclosure forms for HELOCs. Who wants to kick us off on that? I think this is a little bit more lively. Kevin, you always --

MR. RHEIN: I don't know that we had a -- let's see. There are the compensation rules. I guess we definitely felt the static disclosure enhancements were excellent.

The static disclosure documents, certain things could happen much faster than others, and if you have something that isn't APR-driven, it's just more information to a consumer. We thought some of the testing and work that had been done there was very good, and those would be easy to do on a fairly easy basis. We again were concerned a little bit about the lead time if you do get into disclosures involving the APR, the systems work that's required in those particular areas.

Do you want to get into the acceleration of this? Are you talking about the additional protections as well?

There was some discussion about the 30-day time frame -- the difference between reducing somebody's credit line and letting them pay out over the period of time versus terminating a line. The suggestion was 30-day delinquency could be a trigger to terminate. We were perfectly fine with that. We did not see any issues there. In fact, we wouldn't accelerate it. It's something you tell them with the charge-off, which would be 180 days, but we had no objection on the 30-day side.

MS. HASSON: Okay. I think there were some counter views on the 30 days. Mike?

MR. CALHOUN: We discussed yesterday that the 30-day standard allows termination of a line of home equity credit and that that seems more drastic than some of the credit card actions that require now a 60-day late period. Staff indicated that that was something that they were looking at, and we would certainly advocate that those be brought into line, that there be 60-day lates before a home equity line -- which is, for a lot of people, a key line of credit -- is terminated.

MS. HASSON: There was a great deal of discussion in that realm about small businesses, so I don't know if, Ron, you want to jump in.

MR. PHILLIPS: Thank you. I think that's right. What we've said, and some of us do a lot of business lending from the bank standpoint, obviously, and alternative lenders, HELOCs are a source of capital for small business.

Cooke has made the comment that small businesses are also consumers, and so the question is begged to what extent going forward we can begin to think more clearly about any of these rules and protections that are being looked at in disclosures and forms for consumers should also migrate over to small businesses.

An example of that is on these forms that were put forward, which are quite good. In many instances, when a consumer is borrowing a home equity line, some of the comments at the end of the forms warn or suggest to the individual some warnings that they might want to be aware of. Those kinds of questions may also be asked or addressed if somebody is borrowing off their home for small business use and what journey awaits that business and the quality and character of that ability to pay back that line when you're using it for business purposes. I think that was one area that we were commenting on.

MS. HASSON: Cooke, did you also --

MR. SUNOO: Well, only that we know that the HELOCs are, in fact -- and I always have trouble with this statement, I apologize -- among entrepreneurs who are homeowners, in general the HELOC provides the principal source of capital for their businesses to 30 percent of those in that class. That's a very large number.

In the Asian immigrant community, that number more than doubles so that you're at 60 percent to 75 percent of those homeowner entrepreneurs that rely on the HELOC as a principal source of capital for their business. I've got to admit I'm not absolutely clear on how the banks differentiate, but the fact that these loans are affecting not a lifestyle, per se. It's affecting a livelihood. I think that the underwriting review of these have to be something that gets taken into account.

The across-the-board cutting back of lines based on scientific evidence where there is a diminution of value in a region of houses and all HELOCs are then cut back by a similar corresponding percentage is something that we've gone through as a business assistance organization and had to unravel and reinstate these lines for a number of entrepreneurs who, in fact, their particular home, their particular cul-de-sac, their particular sub-region within the region was not as affected by the across-the-board diminution of housing value. There are classes of impacts that this makes on different types of loan users.

MS. HASSON: Okay. Jim?

MR. PARK: Just to reiterate a little bit of what Cooke talked about, we did have quite a bit of discussion around reinstatement issues. Clearly, markets are very different, whether you're in Los Angeles or Chicago or San Diego like I am.

Not all markets are the same, and the decline in home values have not been the same throughout that region. The concern is, among a lot of folks, that the lending institutions are making some blanket reductions in either the home equity line of credit or even terminating it for various different reasons.

We had a lot of discussion about who bears the cost of reinstatement. Should the consumer bear the cost of reapplying, challenging that reduction or termination, getting the appraisal done, or should the lending institutions do so? The concern is because of the widespread reduction in home prices, some of us I think feel that lending institutions might be slightly more aggressive about the reduction process than they might need to be. Therefore, should the onus then be back on the lending institution to cover some of that reinstatement cost if they were at fault or did not do the appropriate analytics around those reductions?

I think clearly the consumer groups feel that the lending institutions should cover at least the initial cost, but I think Kevin and others had sort of different perspective about that, obviously.

MS. HASSON: Okay. Kevin?

MR. RHEIN: Yes, and, actually, I think this was where we had more discussion yesterday was around really the suspension of a line or reduction of a line and the consumer's ability to basically appeal the decision and what would happen.

There were two things that we felt that were important. Number one, the 30-day standard to process an appeal. We thought that was fine as long as the clock starts from when the information is complete. If we've asked for tax returns and we've required new appraised values or something like that, you can't make a decision until you've got the information. We would just encourage the Fed to define that 30-day standard from when the information has been provided that's been requested.

Relative to the cost, I am not sure how we feel about it, but I would generally say our concern would be there certainly are a lot of reductions that have been done. There's been a tremendous amount of value lost in real estate. Our worry would be that somebody can just appeal everything, and you would absolutely flood the organization with appeal requests, drive up a tremendous amount of cost where I frankly believe we would be right the vast majority of the time.

So, somehow in this process we'd have to work something out that said maybe a consumer would have to provide a reapply fee that if we're wrong, maybe we eat it. If we lowered somebody's value when, in fact, we got an actual appraisal, and the appraised value came out okay, then we would eat the cost of the appraisal. But to just let people appeal a decision without having any skin in the game doesn't make any sense to us. We just don't think that would be an appropriate process. So how we find some way of dealing with the appeal costs and making sure that it's not just whimsical or whatever you want to call it is, I think, very important.

MS. HASSON: Thank you. Terry?

MR. THEOLOGIDES: Yes, I agree with Kevin on that. When institutions are managing lines, they oftentimes have other relationships with those customers. They take care not to be wrong on that. While Reg Z permits an institution not to use a full appraisal, for obvious reasons, the models that prevail in the market are actually pretty darn accurate at segmenting within communities at certain price points what the declines are.

My sense anecdotally -- sorry, Patty -- from institutions is that the successful appeal rate is actually fairly low. Again, point out that 50 percent decline in value is a safe harbor, so there still may be the ability to manage the line if it was a 48 percent decline. That doesn't necessarily mean that at 50 it's automatic reinstatement.

The concern is if there is a blanket right to demand a full appraisal appeal with no cost whatsoever that that will become the norm. Everyone will know you got one give-me at that, and that will impose costs that will somehow be passed through in one way or another. I think something more along the lines of permitting appeals, and the institution managing it bears that cost if, in fact, further analysis shows that the line should not have been suspended or reduced.

MS. HASSON: Kathleen?

MS. ENGEL: I think that this is one of those areas where, because this is a new phenomenon, the cutting back on the lines is in response to the current crisis, and so we're in kind of uncharted territory. What we probably need at this point is something beyond what people's impressions are of how this system works and that this might be an area where some investigation by the Fed would be helpful in advance to look at what are the percent of requests for reinstatement, what's the cost of reviewing the requests on average, and what are the outcomes, just so that there can be some informed policymaking, given that we don't really have an empirical record on which to base the rule.

MS. HASSON: Mary?

MS. TINGERTHAL: I'd just like to echo what Kathleen just said. I think this is very knowable statistics but not necessarily something that the banks or the regulators have had to take a look at in the past. With all due respect to my lender colleagues, while the tools to analyze a HELOC portfolio are very sophisticated, they still on an individual homeowner basis have the effect of being a lot more like a machete than a scalpel. So I would be very disappointed to see a rule that had the ability of a lender to charge a large up-front fee just to get a review undertaken, because if you're a consumer that really has been trying to manage their credit, has a line of credit in place, wants to be able to keep that line of credit in place, gets a notice, and they say, "Well, you know, this just isn't right."

There are many factors besides the value that come into play, including loan-to-value ratios, and it may include loans that the particular bank knows nothing about. I really would ask that even if there is sort of a nominal review fee -- $10, $25, something like that, a little bit of a serious note -- I would really ask that we not adopt a rule that would require hundreds of dollars just to get your review undertaken.

MS. HASSON: On this line, I'm going to even go the opposite and say I think again the burden should be on the lender who is taking the action. I think it's in the wording that you use in your letter to the consumer explaining why you are reducing their line and giving them the understanding and the information that they need to understand.

In some cases, people may go, "You know what? They are right. Eight houses in my block are in foreclosure. The value in my neighborhood has gone down."

In other cases, they're going to fight you. I think that you have to be held accountable for the action you're taking. If you feel justified in it, then support that justification. So I would say that the way it stands now should stay. The first burden should stay with the lender.

Kevin?

MR. RHEIN: Obviously, I disagree, but beyond that, one of the things the Fed might want to do is take a look at the OCC examination policies as to when they go in and take a look at a lender's portfolio. What do they look at to say is a loan impaired, is the appropriate value being reflected on the books, things like that. The tools that lenders use in many of those areas are things like automated valuation services, tax rolls from county tax providers, things like that, to try to assess those home values.

The reality is you are dealing with hundreds of thousands of units across different groups. You have to use automated databases, and, Jason, I don't know if you can chime in on the value of where a lot of these sources of information come from, whether it be in credit quality or valuation services overall.

We've already gone through the analysis. We've made the decision. We believe it's an appropriate justification. For us to then have to incur significant additional costs where the consumer can just, frankly, run up the cost bills and then distract us from doing other things that might be modifying somebody else's mortgage just doesn't strike me as a balanced process overall.

MS. HASSON: I do think that, again, you know all of the information that you use to make that decision. I don't think a lot of that information is relayed to consumers. So if you relay that information in why you are cutting their lines, perhaps you won't get as many appeals, and they'd buy into the logic that you use. In some cases, they're not going to, and they're going to appeal. I think that that action should be supported by you, and you should be willing to support it through your cost.

MR. PARK: The discussion around who is going to bear the cost of reinstatement, that's going to go on for a while, I suspect, but it is a big issue, obviously. A lot of consumers are being hit with reduction and termination of their HELOCs, more than ever before, and obviously there's 20 million homes underwater, so you can see how that's going to continue down the road. It's going to hit more people.

I think one thing that we learned from the staff here yesterday is -- and I learned some new stuff yesterday around the whole HELOC termination and reduction. There are some specific factors that the lender has to meet in order to be able to pursue a reduction or termination of the HELOC. I'm sure Wells and others are doing a great job around the table, but I honestly think there is not a consistent mechanism or protocol around this within the industry, because it just has never been a big issue.

We do know people who have gotten their HELOCs reduced or terminated that I don't think necessarily met those factors. So I think in some ways examiners and others that go out, they should kind of review those things, make sure that lenders are fully aware of those factors, they're in compliance with those factors, and make sure that people who really should not be subject to those reductions or terminations are not hit with those situations. I think, hopefully, that we can all agree on, and I think we can continue the discussion around who should bear the cost of the reinstatement over time.

MS. HASSON: Okay. Are there any other comments?

MS. SAWADY: Just briefly to note that this is one of the times where the safety-and-soundness issue really comes face-to-face with the consumer protection, and as long as they can be merged, it bodes for a good solution.

MS. HASSON: Okay. With that, we'll move to compensation.

MR. RHEIN: Something less controversial, right?

MS. HASSON: Yes. Is there anyone who would like to lead off the -- Joe?

MS. SAWADY: The person we never hear from.

MR. FALK: I object to the disparate treatment and disparate impact contained in the proposal on businesses that employ loan officers. I understand that we've come from a place where loan officers were allowed certain incentives where they personally benefitted, and I understand that we have to address that issue. Clearly, Congress saw the benefits of regulation of loan officers when they passed the SAFE Act requiring education, licensing, criminal background checks, and a unique identifier number.

But this proposal goes further. This proposal defines a loan originator to include mortgage broker businesses that employ loan officers. This creates disparate treatment and disparate impact, because direct competitors dealing with consumers at the company level are being treated differently as it relates to compensation, limits on compensation, and the nature and the form of that compensation.

So, at the business level, treat competing businesses the same. Mortgage broker businesses are by definition small. Treat small businesses the same as their larger competitors as it relates to their compensation form and amounts.

I agree that loan officers, the individuals with a unique identifier number, those folks, okay, let's make sure that they do not personally profit from up-selling, steering, extra charges, unique features. But for the businesses that employ them, treat them all the same.

MR. CAMERON: Patty?

MS. HASSON: Am I -- there is a glare in here. I'm sorry, Alan.

MR. CAMERON: Well, it should come as no surprise that I agree with Joe. Credit unions are, by and large, very small entities, much like many small community banks who don't have the size that allows them to hold mortgage loans in portfolio. As a consequence, they act as a mortgage broker. They make mortgages, and then they sell those primarily to Fannie Mae or Freddie Mac but oftentimes to other lenders, and many community banks do the same thing.

So one -- and Patty, again, like Terry I'll use one of your hated terms -- unintended consequence of this would be to put credit unions and many small community banks out of the mortgage business. That, obviously, would have the effect of diminishing competition and therefore would be harmful to consumers.

I do agree with Joe that what we hope to do here is to limit the steering of consumers to bad loans, loans that are not in their best interest, and the way to get at that is by limiting or restricting the compensation schemes, the incentive schemes that might be proffered to loan originators, those who have a number under the SAFE Act. I would strongly urge the Board to reconsider the definition in this rule and to not have it apply to mortgage brokers but only to loan originators.

MS. HASSON: Shanna?

MS. SMITH: I just want to remind people to look at the Department of Justice lawsuit against Chevy Chase in the early nineties so that when you're talking about compensation for loan originators, loan officers, it's not tied to the amount of the loan, because there have been cases of disparate impact, disparate treatment based on the loan amount. As the Fed is looking at this compensation issue, just to review some of the fair lending lawsuits.

MR. NAVARRETE: I just wanted to comment briefly on a different dimension of this, which is that the regulation and supervision of compensation practices, at least as it regards banks, has been part of the equation for many years and actually predates some of the more specific rules that are being contemplated now.

I think one worry we have as part of the banking industry is, notwithstanding the desirability of coming up with sort of a consistent statutory or regulatory framework, enforcement for non-banks in particular is going to be quite a challenge. So we would urge the Board to consider means to ensure that whatever rules are ultimately adopted are applied consistently to banks and non-banks.

MS. HASSON: Mike?

MR. CALHOUN: I think this is a difficult rule but one of the most important that the Board has considered in many years. The difficulty is reflected, I think, in part that the Board issued regulations, did some testing to see if disclosures would address this problem, and the testing indicated it would not. Then they came back with this rule, which we strongly support and believe is one of the most important things that could be done to prevent another crisis like we are enduring right now.

I think, first, there has been some acknowledgment, but just to be clear, this was not an accidental crisis. People didn't just find themselves in bad loans. Subprime borrowers did not go from 3 percent wanting no-doc loans to the majority of subprime loans having no documentation.

In fact, we found from discussions with borrowers that the majority of no-doc subprime borrowers didn't know they were in a no-doc loan. They had a regular salary, a W-2. They brought in the information. What happened, though, is the loan officer or, more typically, the mortgage broker received additional compensation for putting the person in a no-doc loan, because that typically included an extra 100 basis points of interest on the loan simply for that one change.

We saw the same thing with Alt-A loans, with the hybrid ARMs, the 2-28s. They all paid two and three times as much compensation to the broker as a 30-year fixed rate, which the borrower often qualified for and would have had a lower starting monthly payment, not just eventual monthly payment. So we really do think this is a critical intersection of are you going to change the conduct we had before.

A couple points. First, this proposal does not cap compensation. Brokers are free to set the level of their compensation wherever they choose. This does not cap loan rates. Lenders are free to set their loan interest rates, which obviously affects profitability at whatever level that they want.

We believe that the proposal appropriately makes classifications based on function, not name. That is, is it an entity that is providing the credit, or is it a salesperson, either a loan officer or a broker, who is advising the borrower as to which product to choose.

We also think that this rule follows the empirical data and is carefully targeted. The data repeatedly show, for example, that mixed fees, where brokers receive compensation as an up-front fee and from the lender's yield-spread premium, are very confusing to borrowers and overwhelmingly result in higher fees. The fees are additional, not a substitute, as their proper justification would be, and this rule appropriately stops that practice.

We would also note our research finds that brokers have served very well in the areas where there has been little of those mixed fees. Our research shows that brokers actually provided lower rates in the prime and near-prime space where those mixed fees were unusual but provided significantly higher, on average, about 200 basis points higher, controlling for credit characteristics when you got into the subprime space, where you typically had the mixed fees of up-front fees and back-end fees. So we think addressing that is one of the most important things.

This is not a perfect cure-all. There is no perfect cure-all, but it's far preferable to alternatives, for example, the carve-out for brokers. Joe and I talked about it this morning. If you say that a broker simply by incorporating as a separate entity can now get incentive payments, that loophole swallows the whole rule.

All of the changes, I think, make the rule less effective and provide less of a level playing field. We would note we had a presentation yesterday from the Fed staff about fair housing and equal credit screening, and one of the points of emphasis was, first of all, that more of that is being done, and it's needed.

This rule will not be the cure-all, particularly with lending operations, but this discretionary pricing with incentive compensation is one of the highlights of what generates disparate pricing to consumers. So, once again, we commend the Fed for its extensive work in this area and for its proposed rule.

MS. HASSON: Edna and then Joe?

MS. SAWADY: I was just pointing to Kevin.

MS. HASSON: Okay.

MR. RHEIN: I wanted to maybe talk a little bit about the bright line around this notion of steering. There was some discussion or proposal around if a broker or loan originator provided multiple options, how do you make sure that they're not steering in the process of doing that. I just think what's proposed right now is not a clear, bright line, so I think there needs to be a clear understanding as to what would clearly satisfy any concerns around whether somebody was trying to steer or not.

Then the other question is how would that process start to fit in with some of the other requirements around providing Good Faith Estimates. If somebody is providing three different alternatives, in fact, then, are there going to have to be three different applications, three different Good Faith Estimates?

So, trying to think through the process beyond that initial disclosure or that initial presentation of alternatives into starting the mortgage application process, I think that's got to be thought through and well understood in crafting in this particular space.

MS. HASSON: Joe?

MR. FALK: I do understand that there are people around the room that don't like mortgage brokers. I know that, but I believe there is a place for financial intermediaries in the financial services space.

Let us be clear. The abuses that happened in the mortgage broker industry were not appropriate, but to say that the large institutions did not also engage in those practices is dishonest. There are lawsuits all over the country against large institutions that had incentivized compensation based upon product choice by incentivization by product features that were actually within the large institutions.

So while you may blame the small little businesses out there, and you may drive them into the dirt, put them all out of business, you will miss us when we are gone. Small communities, underserved communities will miss small businesses that distribute good products into communities that have not been served by the large institutions.

The large institutions cannot proudly beat their chest how they have gone into small, underserved communities over the last twenty years and provided reasonable services. Ten years from now, we will be back to the place we were in the 1980s, 1990s, demanding that banks open little kiosks and little bricks-and-mortar shops in local rural communities all over this country.

If that's where you want to go back to, drive all the little businesses out of business. Please don't disadvantage small business to advantage the large businesses that, in my view, have not earned that trust.

MS. HASSON: Okay I have Tom, Saurabh, Shanna, and then Kathleen.

MR. JAMES: Well, Joe, I think we've been here before. First of all, the rates are so low right now that I am thinking of refinancing, and I'm going to use a mortgage broker. Of the things that I think we've addressed over my three years and with my background, certainly the two biggest concerns I had that I wanted folks here to hear about were yield-spread premiums and prepayment penalties and overages, discount points, revenue factors, whatever those things are called. But they appear in this area, and they drive the incentives at retail.

The problems that we've seen around yield-spread premiums in particular boil down to the fact that, at the end of the day, for most people we've seen, they have successfully obscured price. They have made it impossible for consumers to know the price of the product. Where that doesn't happen, supply and demand don't meet, and there is immediate market dysfunction that shoots through the system.

There is almost a perfect defiance of the reasonable expectation of the consumer who comes into the transaction. It's a transaction with a mortgage broker, a transaction affinity. The reason I go to my mortgage broker is because I trust my mortgage broker more than I trust myself in the marketplace, and they have unique experience and skill and familiarity. The ability to essentially take a kickback from another player in the transaction guarantees that the basic features of the transaction are likely and almost always corrupted, so I really want to commend the Board for going at this problem.

I was very scared when I saw the RESPA disclosure come out with a provision for yield-spread premium that I thought did nothing but add to the problem. This really needs to be attacked and dealt with at the most fundamental level, and that level is price and the reasonable expectation of the borrower in the transaction.

MR. NARAIN: Thank you. As you think about compensation, the idea of compensation is really about steering people and getting more cash to the people originating complex transactions.

With a background in derivatives, one has to really think about how is that cash generated, because there would be no extra compensation if there is no cash generated. Cash is actually generated through greater complexity in the product, the option ARMs and payment-option ARMs, interest-only structures, and so on, and opacity. As we think about fixing some of the issues that have caused this crisis, as Mike was saying, we've walked down two steps. One is a suitability criteria, which we have sort of successfully done, and the Fed has taken some very tremendous steps along that path.

Disclosure, again -- we have walked down a tremendous path there. And then, standard compensation across products. I am totally in favor of standard compensation with suitability and disclosure. I never knew there would be a time when I would agree about supporting mortgage brokers, but I think we are supporting responsible mortgage brokers, Joe, and I agree with that.

Not only do we have standard compensation, but a fair treatment for small businesses and mortgage brokers would be an appropriate step moving forward with suitability and good disclosure. Thank you.

MS. HASSON: Shanna?

MS. SMITH: I am, fortunately, I guess, old enough to remember that it was mortgage brokers who made loans in neighborhoods of color when the banks were redlining those neighborhoods, and many of them did a very good job. The issue of steering is not isolated to mortgage brokers. Our testing and investigations continue to show that banks steer qualified African-American, Latino, and Asian-American borrowers to the higher-cost loans with more fees in their institutions.

In the steering issue, we have worked with banks and lenders to see what kind of applications came in through the brokers, and we've been confounded at why a borrower didn't accept a counteroffer from a lender through the broker when it was on better terms and conditions than they actually originally requested. It goes back to what Mike Calhoun was saying. It's where was the incentive for the broker or the loan originator to push that better loan product, because the incentives were to pay them more for products that weren't so good.

Our position is that you get to see as the consumer all the counteroffers, all the offers that are available to you, and not limit it to one or two if there is another loan product that provides a lower down payment, that provides a lower interest rate, or over the term of the loan is a better product for the individual. Without that option, a consumer is going to end up, as they have traditionally, with not the best product for their income level.

MS. HASSON: Kathleen?

MS. ENGEL: Just a couple of quick things. One is in the memo from the Board staff, the writers switch between the use of the word "payments" and "compensation" in talking about YSPs and overages, and I think it probably should be "incentives." I would hate to see this rule go through and then people start getting awarded, you know, month-long vacations in Hawaii based on loan terms, which might not fall within the definition of compensation. Maybe that's detailed in the full proposed rule, but I just wanted to mention that.

I think a flat fee is preferable to a percentage-based, because I think that if it's a percentage-based compensation for brokers and loan officers potentially that we really do more to impede low- and moderate-income borrowers' access to credit. And given right now that they're having reduced access to credit generally because of changes in the market, to create disincentives for them to be able to get mortgage products would be a problem.

The other thing is I am concerned about the safe harbor provision or alternative in the proposed rule, because I think that one of the reasons that we've seen the problems in the mortgage market is that there have been a lot of sort of loopholes and gaps and slippery slopes and all those great words to basically describe that there are ways that there can be abuses when there's ambiguity or where there are gaps and that we need to have very bright line rules.

It helps both to ensure fair credit, and it also helps lenders to know exactly what they're expected to do. Vague things and safe harbors and things like that, I think, are dangerous territory. I also think it's problematic where here the safe harbor is to present the borrowers with additional loan options, even though, like Shanna, I think that they should be given additional loan options.

One of the problems in the market is complexity and too much paper and consumer confusion. If we say that the safe harbor is to increase the complexity and consumer confusion, that doesn't sound like a safe harbor to me. First of all, I am opposed to a safe harbor, and if there is one, it should not be one that means that we're throwing even more information at consumers that they can't parse.

MS. HASSON: To add to that, I have a really radical idea for the Fed. You need to hire a dishonest mortgage broker as a consultant to tell you how he would beat this. And I'm not kidding, because as I sit here and think about this, I go --

MR. FALK: Hire a dishonest banker. There's lots of dishonest bankers out there, too.

MS. HASSON: Okay, or a dishonest banker, because I'm not evil enough to do this. But if I were to look at this, I was sitting here going, "How could I beat this?" If you look at the technical terms, it says you present a loan with the lowest interest rate and settlement costs. So I could present this relatively new person in the marketplace with a very lower income, who I should be putting in a 30-year fixed mortgage, who can be stabilized, and this is what they can afford based on their mortgage, but I don't even shop that loan.

I get them three ARMs that are low rates, and I say, "Well, I did my job. Here's my safe harbor. I gave you three options. They were the three lowest rates I found," but not necessarily in the best interest of that consumer. So, I meet the definition of the safe harbor, and I can go on.

I say that kiddingly, but seriously I think that's one of the things we constantly have to be thinking. Not that anybody in this room would do that, but those who would, how would they try and use some of this language and safe harbors to really benefit themselves and still make that extra compensation?

MS. ENGEL: It would help with the unemployment crisis, too. You know, the Fed hires ex-felons to assist them.

MS. HASSON: Joe?

MR. FALK: Since Tom brought up YSPs, and this is my last meeting, I have to once again remind all my consumer advocacy friends. You don't like what you see, and therefore you like what you don't see.

Mortgage brokers by HUD's definition are required to report and disclose indirect compensation. They're called yield spreads, but creditor-lenders are not required to disclose their back-end compensation, their incentivized compensation, their extra benefits for pre-payment penalties, option ARMs, and the very features that were added to these loans by all loan officers. So you don't like what you see, and you're okay with what you don't see.

I'll segue lastly to the debate that we will have about the auto crisis and auto loans. There is a direct analogy. The non-disclosure of back-end compensation to auto dealers, auto finance merchants is the same analogous argument, so be careful. What you see, you can complain about, but what you don't see, arguably, is just okay.

MS. HASSON: Okay. On that, Edna?

MS. SAWADY: Thank you. Well, Joe, thank you for very inspiring last words. We'll take a break now. After the break, we have an equally important topic of credit cards, so brace yourselves. There's more. We will take a 15-minute break, so we will be back at 10:40. Thank you.

(Whereupon, the foregoing matter went off the record at 10:25 a.m. and resumed at 10:45 a.m.)

MS. SAWADY: The next discussion item revolves around the Credit Card Accountability Responsibility and Disclosure Act. In May, President Obama signed the Credit Card Accountability Responsibility, and Disclosure Act of 2009. The Act includes a number of new substantive disclosure requirements to establish fair and transparent practices for open-end consumer credit plans.

It's interesting to see the repeated wording of disclosure requirements, fair and transparent practices, so that's what the CAC is all about, whether it's mortgages, Joe mentioned the auto, whether it's credit cards. That's the bulk of what we do, and we are very glad to be part of it.

Last month, the Board issued a proposed rule to implement the provisions of the Credit Card Act that go into effect on February 22, 2010. I'm sure you will get a kick out of the date, because you'll hear a lot of discussion of what's going to happen on February 22, 2010. I'll just give you a sneak preview -- don't go to the grocery store.

MR. RHEIN: Or buy gas or anything else.

MS. SAWADY: The proposal addresses the majority of the provisions in the Act for which the Board has rulemaking authority. Yesterday, members of the Consumer Credit Committee discussed several of these provisions, and at this point I'd like to turn it to Tom James, the Chair of the Consumer Credit Committee, to lead the discussion. Tom?

MR. JAMES: Thank you. The Credit Card Act prohibits creditors from opening a new credit account or increasing the credit limit for an existing credit card account unless the creditor considers the consumer's ability to make required payments under the terms of the account. Credit card accounts typically require consumers to make a minimum monthly payment that is a percentage of the total balance. Accordingly, the proposed rule would require creditors to consider the consumer's ability to make the required payments -- in other words, the ability to pay on the account.

Because the creditor will not know the exact amount of the consumer's minimum payment at the time it is evaluating the consumer's ability to make those payments, the proposal will require creditors to use reasonable methods for estimating a consumer's minimum payment and would provide a safe harbor that creditors could use to satisfy that requirement.

Essentially yesterday, in view of this provision, we had a discussion that revolved around three factors, the first being what constituted a full utilization of a creditor's account line for the purposes of determining reasonable ability to pay and, second, the factors that went into the creditor's consideration of the capacity of the consumer to pay -- their income, assets, and obligations.

As an assistant attorney general, I think -- and I think I'm speaking for most assistant attorneys general when I say this -- we spend most of our time chasing folks into safe harbors, so the outlines of a safe harbor are pretty important. Ability to pay is fundamental, of course, to setting up any relationship around a credit transaction, and I think I wanted to start with Andres in terms of the banks' approach to this.

MR. NAVARRETE: Excellent. Thank you, Tom, and Sandy had just commented that I was uncharacteristically silent today, and I said, "Just wait." Many, many experts in the mortgage field, but the credit card provisions in this case are actually relatively technical, I think, in comparison. I also joked with Patty earlier that sort of the broader debate on credit cards, I think, has been largely settled, and so we sort of concede a number of issues that I think had sparked a lot of interesting dialogue over the years.

In this instance, I think we're talking about things that are a little bit more tactical. Continuing a theme from this morning, I want to pay a very high compliment to the Board staff for developing what I think are an extremely balanced and thoughtful set of regulations, both on the ninety-day provisions, which came out earlier, and then the nine-month provisions, which we are discussing today. That is, I think, all the more impressive given some of the challenges with the source material, and so I really do think that the work here and the effort that has gone into coming up with something reasonable is to be commended.

That said, we do have some comments about specific provisions. I think they are relatively modest, and so I'll go into those. I think we're going to divide the discussion into two pieces -- first, on the ability to repay and then talking a little bit about the over-limit provisions.

From a practical standpoint, what the provisions ask for is just for us to consider both bureau data and income or asset data, and I think both of those, as I said, are quite reasonable.

The biggest challenge is not going to be obtaining that data on a going-forward basis. I think for new accounts it's relatively simple to include income -- a request for income data from the consumer as part of the application process. That's pretty much standard practice today. But given that income has not typically been the most predictive element of the underwriting decision, past payment history, total debt, et cetera, there are a lot of other factors that I think have been more substantial in terms of our underwriting criteria.

The fact is that there is a substantial part of the existing book where that income data is either not available or at this point, particularly for longer-term customers, potentially out of date. It could be quite disruptive and off-putting to our customer base to go back and ask for income data when we're considering specifically credit line increases.

So we would request the Board staff to look at two things. One is the ability to look at payment history, especially for longer-term accounts, when considering credit line increases. Payment history is, not surprisingly, the best indicator of not only ability to repay but also willingness to repay and likelihood of repayment, and so it captures a lot of the safety-and-soundness and consumer concerns that we think are evident in this particular provision.

Secondly, we would like the Board to consider use of modeled income as a substitute for requested income. Again, modeled income can often be more predictive of risk. So long as it's done under reasonable procedures that are documented and can be examined by our federal regulators, we think that that could be an extremely effective way of satisfying the requirement.

The other overlay, of course, would be that we would want it to be fully compliant with all Reg B requirements to ensure that only proper criteria are being used. We think that both of those could be elements added to the rule to strike the right balance.

MR. ENGEL: Yes, Andy, just as we discussed yesterday in our meetings and just to amplify that point with regard to credit reports, the rule as proposed does recognize, obviously, that you can find the consumer's obligations in large part on the credit report. I don't want to discount too much, though, that there is a correlation between propensity to pay and payment of those obligations reflected on the credit report and ability to pay.

If you know the consumer has a mortgage and the monthly payment is listed on the credit report and has a car payment or other installment payment with a monthly payment listed on the credit report and other revolving amounts listed on the credit report, and the consumer has paid those consistently, you can start to make assumptions about income and ability to pay. I think that's intuitive in the systems that the banks and lenders use now.

It's something that we're now approaching with more mathematical rigor, as you would with any scoring system, and applying empirically derived and statistically sound systems to and things we're working on. We would hope that the rule would recognize, if not simply in particular situations as Andy raised with new accounts or retail point of sale, where it may be difficult just for privacy reasons to get income from the consumer, or those credit card amounts may be, if not de minimis, at least small enough that there be an exception to the rule, but I think even more broadly that the credit report and the modeling that we're doing and will do ongoing and the insight that gives you to income is something that should be explicitly recognized in the rule as one of the places that you can derive ability to pay overall, including inferred income and assets.

MR. JAMES: Patty?

MS. HASSON: I recognize I'd be insane if I said that you needed to collect W-2s on everybody who applies for a credit card, so I won't go to that extreme. My concern is with this data and the self-reporting of people on a form saying, "This is what my income is." I think that the Fed needs to watch very carefully how they're using that information and that modeling to make sure. I don't think we want to just necessarily give it carte blanche. We've got to really monitor the information that they are gathering and verify that it is accurate.

The second point I'll make, which just dawned on me as I was looking at it, is I think it's a little bit different for the 21-year-olds. I think you have to be very careful about going there, because the exact statement says that the information, including the underage consumer, has the ability to make the required payments for the account.

I think I would treat that a little differently, and I would require some type of income verification for those under 21 and not use some modeling-type technique, because, quite frankly, it could have been the parents paying the bill. So while they look like they have this ability to pay, it could have been their parents. I think that is one exception I would request, is that for 21-year-olds that there has to be some type of income verification -- or under 21.

MR. JAMES: Kevin?

MR. RHEIN: A couple of other points I wanted to mention. One was looking at things at an account level versus an individual level. We talked a little bit about this yesterday.

So it starts to talk about income or ability to pay for the borrower, and in many cases there are multiple borrowers. The way accounts are managed is at the account level, not necessarily with the individual borrowers. So when you start to take a look at the analysis and the requirements, we'd certainly want to try to make sure the Fed has appreciated the fact that we manage things at the account level is the first point.

The second is this question of minimum payments. I don't think any of the issuers had a problem extrapolating a minimum payment based on full utilization of the line, but we got into a discussion yesterday about what about all their other cards. In general, across the industry people might have multiple cards. The line utilization is typically around 30 percent.

What we don't want to get into in trying to determine an ability to pay is to have to assume that all the lines are maxed out and calculate payments based on all the lines in determining whether we would be granting a line increase or granting new credit. We would ask for clarifications in the reg to make sure that we're only talking about a new extension of credit from an individual creditor or, if it applied to a line increase, not what's happening with their other cards.

MR. JAMES: Edna?

MS. SAWADY: Thank you. Before Josh left last year, I promised him that we will not forget that the credit card is an evergreen, open-ended, unsecured product. I'd just like to remind us of that and to put it into perspective when we're talking about W-2s and income verification and all that. What is really the product we are talking about?

As you know, I've had the privilege of being in the community development space in a very large bank, so I have both the consumer advocacy bug in me, but I also know what operational procedures are involved in how the machine works. I have seen model data more than anybody else wants to see it, and I do believe in it.

I think it's very accurate. It may be more accurate than reported income, may be more accurate even than verified income. So I just wanted to put a good word in here, and, Jason, you can pay me later for that. I've really seen it work, including, Patty, the under-21-year-olds, because what the model data is capturing is real-life behavior, so if their parents paid for it, that's okay. Their parents also pay for the other credit cards that they are using. Not to say that there couldn't be abuses of it if we need to combat fraud any place we can and not to say that the system is totally perfect, but I think it does the job quite well.

MS. HASSON: I have to counter that with the provision in here that, if your parent is paying it, they can co-sign for it, so I don't agree. I think that the Congress's intent was to make sure that if you're giving someone under 21 a credit card, they have the job to pay. I think that asking and requiring them to verify that is not unreasonable.

I really feel strongly about that. There are too many kids that we are seeing today that are coming out of college. I mean, the statistics -- I don't have the data here, but you can pull the data. The number of college graduates who have credit card debt is astronomical. To give them cards without verifying that they have some viable means to pay it back is just irresponsible.

On a second note, which I just have to quickly say and I've said it before, I feel strongly again that looking at credit lines and full utilization of those credit lines, no creditor in here would give somebody a $50,000 credit line on $24,000 of income, but they'll give them a $10,000 credit card, and they're spreading the risk. You have five credit cards with $10,000 each. It's $50,000. But if you asked them to give one, they wouldn't do it. That's systemic risk with that consumer that we're all paying for in bankruptcies.

I think that it's got to be looked at a little tougher, that people fully utilize all their lines, because the people who do ultimately file bankruptcy or come for credit counseling, use those cards at the moment of need. People keep saying, well, they're not utilizing them. They don't use them. They don't need them. I think we should be looking at their total financial picture.

MR. JAMES: So there is full utilization, and there is multiple-line full utilization.

MS. HASSON: And there can be overrides. I'm not opposed to overrides in looking at it, but it needs to be looked at.

MR. JAMES: Joe?

MR. FALK: I was wondering in the credit card industry, and maybe industry would like to comment, do you see the income verification requirements to be used as a risk-based pricing model? For instance, at certain levels of income, you would charge one rate, and different levels of income you would charge a different rate on the outstanding balances. Do you see this as a vehicle for risk-based pricing on salary and income levels, or will that be blind?

MR. NAVARRETE: Yes, a couple of things. It's a lot to respond to, so I'll try to take these in order. I'll start with Joe's question. Recall my sort of initial comments, which is that income actually is not the best predictor of risk, and so the rates are likely going to be assigned based on bureau data, past history, et cetera. Notwithstanding the limitations of what you can do under the statute in terms of what you require, those will always be the top-tier criteria or criterion for making pricing decisions in particular. Income is probably slightly more important in line assignment, which is obviously another way that we manage risk.

I want to applaud Edna for her comments. I want to make sure that we don't mistakenly sort of analogize the concept of reported income in a credit card context with stated income and some of the problems that that created in the mortgage market.

The very, very crucial distinction is that this is unsecured credit, and so the only risk management tool we have is the customer's ability and willingness to repay. We have no collateral to fall back on. I think part of the problem with stated income was that banks and other mortgage lenders were ignoring the sort of notion of validating or verifying the income, because they could depend on the value of the collateral in a foreclosure context. That obviously doesn't exist in the credit card context, and so we have all the incentive in the world to make sure that whatever income is reported is actually realistic given the customer's other obligations, and that is part of the process already of what we do.

On the full utilization point, I think this is another area where we want to be very, very careful. I won't use the term unintended consequences, but the fact is that we oftentimes -- and Jason, I'm sure, can back this up -- look at utilization and low utilization rates as a good thing from a credit-score perspective. Somebody with a 30 percent utilization across multiple lines is a lower risk than somebody with a, say, 90 percent utilization on a single line. So it would be odd to reward the customer for low utilization but then penalize them for having too many cards when we're considering ability to repay.

That would, I think, throw the models into complete turmoil. I just want to make sure that we're not penalizing those customers who are responsible in spreading their risk out by penalizing them in this manner.

MR. JAMES: And did I miss your anti-competitive argument?

MR. NAVARRETE: Well, yes, I think there's a fairly self-evident anti-competitive point here. When customers are signing up for the card, we don't ask them what they're going to use the card for and whether it's a substitute for an existing card, meaning that they want to stop using their American Express card and start using their Chase card.

So there could be a pretty significant anti-competitive element here if we were to not be able to issue a card simply because a customer has other accounts. I would not want to be in the business of trying to figure out customer intent in those instances, nor do I think that's appropriate.

MR. ENGEL: Just add to that, too, I mean, I don't think there's a reason to make assumptions about existing lines when you can look at their credit report and know what the utilization is currently. I mean, that's historical, and you can see the trends in utilization. The creditors are looking at that data now, so the idea of assuming full utilization of every line the consumer has got I think goes too far.

In fact, you can argue the other way, that one reasonable test for utilization of the new line would be the historical utilization of the consumer's current lines. That would be another way to do the test, as opposed to assuming full utilization.

MS. SAWADY: Governor Tarullo?

GOVERNOR TARULLO: Andy, could I ask -- maybe both Jason and Andy. I thought Patty's point was a slightly different one, which was, okay, so during normal times, utilization, 30 percent utilization tells you a fair amount. But she's trying to anticipate. She's kind of doing a risk assessment. What happens under a stress condition? Just as with any kind of loan, collateralized or otherwise, you want to think what happens under a stress condition, how do you take account of the anticipated stress, which I think was inherent in Patty's question.

MR. NAVARRETE: Governor, I think that's a great question, but I hope this answer doesn't sound like it's trying to be evasive. In fact, what has occurred in a stress scenario is that we've stopped issuing credit cards or are cutting back credit. So what happens typically in those instances is that the availability of new credit contracts, and we've certainly seen that with some analyst reports that suggested it's contracting at a rate of about $15 billion a month.

In this instance, there are other risk management tools there. I think the fact is that when we're assessing a customer's ability to repay for the purposes of either offering a credit line increase or issuing a new card, chances are that's not going to be occurring in a stress scenario. That's going to be occurring during, quote-unquote, better economic times.

MS. HASSON: I just want to add to that, though, because these are people who already have these cards. We're not talking about somebody coming in and getting a new card. It's people who have these cards, because you gave the fifth card for $10,000.

It was a long time ago, but I worked for a credit card company, and our marketing department thought we had the best product out there. Somebody wanted the Flyers card or the Phillies card, so they would obviously get that card, except they still had those four other lines of credit that were open. So, exactly what you're saying, in a stress scenario, they're already opened. There are some proactive measures being taken to close lines now.

What I've heard consistently, though, is that's a small percentage of people that you're doing that to. I don't know if that answers it, but I think these are still open, so I'm not hearing how you're testing for stress in the future.

MR. NAVARRETE: Part of it, again, is if a customer during good times has 30 percent utilization across, say, three cards, that would mean that there is either extremely light activity or no activity on some of these other cards.

Most of the contraction that has gone on in the industry has been targeting inactive cards, and so, again, there are back-end tools to manage that risk. For companies that don't manage that risk effectively, the consequences are pretty self-evident, which is the credit card industry at the moment is largely unprofitable.

For those companies that extended credit and didn't take steps to then contract that credit or to manage through this sort of stress scenario, they're going to lose money. So there is a very strong incentive not to over-lend in that environment. That's not to say that over-lending didn't occur previously. It's also not to suggest that the consequences of some of that over-lending today are very evident in your world of credit counseling. These are people who obtained cards many,

many years ago, thought that they could handle it responsibly, and now find themselves for a variety of reasons struggling to maintain that.

I will say that that is not likely to be the dynamic in the future, because we have seen what stress looks like, and I think that that will end up having a -- and combine that with the Credit Card Act, and I think you have a very significant paradigm-shift in the industry in terms of how underwriting will be done in the future.

MR. JAMES: Okay. We have gone through over half of our time, and I wanted to get to over-the-limit and opt-in, and I don't think I have to give much of an introduction here. Does anyone want to begin?

MR. NAVARRETE: I'll start again on this issue and --

MS. SAWADY: What a surprise.

MR. NAVARRETE: What a surprise. So you regret you made that comment yet, Sandy? Okay. Excellent.

Again, I want to compliment the staff. These were challenging provisions to implement, and I think the way in which the proposed rules were structured were quite sensible. The model language, I think, provided was quite effective. Again, compliments to the staff for the work that they've done.

I think we had a lively discussion yesterday about the merits of over-limit and that ability for customers to go over-limit. Again, sort of joking with Patty, we sort of concede that that issue has been resolved in the form of offering an opt-in.

The fact is that whether or not people believe that over-limits are a benefit to customers or a detriment to customers, that's been settled by giving customers the choice to opt in. So come February 22, I won't call it Black Tuesday or whatever day it is or the next Y2K, but the fact is that over-limit authorizations will be greatly diminished if not eliminated entirely in some instances.

With customers having the choice to decide whether or not they want this feature on their card, that broader debate about the merits of over-limit, I think, is largely over, which then takes us to a more practical or modest place, which is in implementing these provisions, we would like to see the Board take steps to mitigate the potential disruptive impact to commerce and to consumers on February 22. One way to do that we thought that was reasonable was allowing for companies to begin informing customers of this policy change and securing opt-ins in advance of February 22.

Assuming that we are in full compliance with the proposal, the use of the model language, et cetera, that we'd be able to start this process in advance of February 22 and sort of then phase in the implementation, so that we have a minimum of disruption on the 22nd and also that customers have a chance to be educated on these changes and make whatever choice they think is best for them.

MR. JAMES: Joe?

MR. FALK: I urge a public education program -- the Governors look wonderful on TV -- if we're going to have such an implementation date with the potential of massive numbers of consumers being rejected for overdrafts, that the media be brought in to help educate consumers that there may be consequences when they start charging based upon these rules.

Industry can also play a role in educating their card members that there may be dislocations or rejections at the checkout counter. Vendors also may be brought into the education effort, the large vendors who do massive numbers of credit card charges, also could play a role in helping consumers before the magic date understand that there are consequences to the new rules.

MR. JAMES: Kevin?

MR. RHEIN: No, why don't you go ahead.

MR. JAMES: Kirsten?

MS. KEEFE: First of all, I just want to say that I think this proposed regulation is a really great example of how regulation can really contribute and foster consumer choice and, hopefully, competition in the marketplace.

Consumers, I think, up to this point, even though they've had the choice theoretically to walk away from their credit card, really haven't had choice in what the terms are. I think that this is going to give individuals, especially if they're given a chance ahead of time to opt in and are really educated about that option, meaningful choice in that respect in terms of, do I want to have this protection on my credit card to go over the limit or not.

When thinking about it in my own circumstances whether or not I will opt into this on my Capital One credit card --

MR. NAVARRETE: Take it.

MS. KEEFE: -- I start to think about, well, if the fee is $39, I probably wouldn't, but if Wells Fargo was to give me a credit card and the fee was $29, I might actually opt in for that. I think it's also a really great example of how regulation will hopefully foster some competition in the marketplace.

The one thing that I want to say is that I do hope, as the industry starts sending out notices ahead of time about opting in, that there is federal oversight of what those notices are to ensure that consumers actually do have a true choice, a meaningful choice of what they're getting into.

MR. JAMES: Kevin?

MR. RHEIN: Wells Fargo has made a decision. We're not going to assess over-limit fees, so you could be zero. If you have your W-2 with you, then we can have you apply for the card.

MS. KEEFE: I love how you guys are wooing me.

MR. RHEIN: I guess what I want to encourage the Fed, and a little bit to what Andy is getting at, is what hasn't been done a lot here is any modeling on what the impact might be, and with credit cards, it's passé at this point. But you are going to be approaching a decision around debit cards and over-limit activity on debit cards, and, needless to say, there's even more debit transactions than there are credit card transactions.

Can you look at data? Can you start to understand the number of transactions where there was a credit card that went over its limit? I believe we're giving you all that data today through Argus. All the issuers are providing detailed transaction information on their cards, so I think you could very readily model what that impact is.

I don't know if that's occurring on the debit card side, but not to diminish, just the day commerce stood still. But there will be an impact as many, many card companies, if they might have authorized a transaction before, because they had some compensation for taking the risk, they might not in the future. Likewise, you'll have another scenario whenever the debit card transactions come about.

I think it's pretty important to understand what those implications are, and to the best of my knowledge, there has been no econometrics brought to bear in that analysis. That might cause you to say you phase it in, you start with new accounts, and then maybe over a period of x number of years you've got to phase it out on existing accounts. I think we have a responsibility to cushion the economy in a very fragile time and make sure we're aware of what we're doing.

MR. JAMES: Mike?

MR. SUNOO: Could I just -- on Kevin's remark. It pains me a little, but I think he's absolutely right.

(Laughter.)

MR. RHEIN: We have made progress.

MR. SUNOO: I am signing a Wells Fargo --

MR. RHEIN: If I can get Mike to say that, then I'll know we're really there.

MR. SUNOO: I am signing a Wells Fargo refi on my house next week. I want things to go smoothly. I think he is absolutely right, but my view of that truth might be a little different in anticipation. But February 22 we'll all find out. My view of it is that, as in instances where over-limit transactions are actually stopped, we'll see consumer behavior that's either they'll go crazy, and there will be a revolution, or they'll pull out their other credit card and try that one, or some other mechanism. I think the important thing where I'm agreeing with Kevin is that we should take careful note of this to see what possibilities we might be able to forecast in terms of the debit card revolution that's on its way. If I'm right, I think that the idea that this opting-in stuff, it isn't the end of the world for the banks. It could happen, and the transition could be fairly smooth.

MR. JAMES: Cooke, I kind of wanted to maybe derail us for a second and just jump back to yesterday. You talked pretty eloquently about the dangers of the no-doc aspect, and maybe you should --

MR. SUNOO: Oh, what did I say? It kind of follows the train of thought that we are dealing with an open-ended, unsecured line of credit in terms of credit cards -- open-ended, unsecured line of credit -- and I think with the card legislation that's just gone through, we can expect that there is a real shift.

There's a ground shift in terms of the way credit cards are going to be looked at, the way the credit cards are used, and the way the industry behaves. Tom and I were talking about how, where young people gather there are folks pedaling credit cards. When my kids were younger, they were getting water bottles as an incentive to sign up on the spot for their credit card. Tom tells me that the ante has been raised where his daughter is now being offered a sweatshirt, but the point is --

MR. JAMES: An Illinois sweatshirt.

MR. SUNOO: The right university sweatshirt. But the point is that the idea of asking for an income verification other than a self-declared stated income is not the end of the world, but it is a shift. It is real dramatic shift from the way people sign up for credit cards today. The idea of 35 percent usage of your line, well, that's the norm, so that's what we should underwrite to is a little bit crazy and may not be the new environment which we're moving into.

The historics are important, but the realization that times are changing, and Congress has told us so. It's our job to adjust to that as well and realize that and realize that what we did in the past hasn't been working, so we're looking for new things. I think that's pretty exciting.

MR. NAVARRETE: So, two quick responses to Cooke's very eloquent comments. One is that as we were talking about ability to repay and income, I think one of the precise points we wanted to make is that, yes, in fact, customer behavior has changed in the wake of this economic crisis, will continue to change because of the Credit Card Act provisions.

That ultimately is better as an underwriting tool even than income. You're making a great point, because that's precisely the kind of criteria we want to make sure is available in the mix around decisioning and that we just don't limit it to things like income, which are less reliable predictors.

The other thing I would say is that, addressing Patty's point too about under-21. We didn't have those specific provisions on the agenda to discuss yesterday, but there is a whole framework of provisions that deal specifically with the under-21 consumer, including co-signer requirements, independent ability to repay. So it is, in fact, a stricter standard than the general ability to repay.

I don't want to necessarily taint the discussion about general ability to repay with the under-21 provisions where there are any number of additional restrictions, including getting rid of water bottles and T-shirts and other incentives for those customers to sign up.

MR. JAMES: Ira and then Luz, Mike.

MR. GOLDSTEIN: I don't want to use the word that Patty doesn't want somebody to use, the opposite word, which is the regulation. It's very clear. It's very straightforward notwithstanding the potential for some inconvenience.

The very clear intended consequence of this piece of regulation was that people shouldn't blithely and without information go into and borrow money and incur fees and debt that they didn't know about and expressly consent to. I think in a very plain, short, elegant way, it does it. It was the intended consequence. I think anybody who wrote that bill or the regulation would recognize that there would be a moment in time where somebody may be inconvenienced by it, but that was going to be outweighed by the very much more important piece of it, which is, as I say, to make a fully informed consent to incur debt.

After all, part of the issue, I think, that we're confronting today that we're trying to unwind is the fact that people didn't make those fully informed decisions to give consent to take on debt. I think, notwithstanding the inconvenience, notwithstanding the fact that somebody's transactions may not go through momentarily, unless they have a Wells Fargo credit card, I think that that's actually a perfectly fine thing.

MS. URRUTIA: The Fed has done an excellent job in conducting consumer testing in anticipation of some of these rules and regulations going into place. I think we would like to encourage the Fed -- the changes that are going to take place are going to have immediate impact on the consumer within three, six, nine, twelve months. I think it would be important to have consumer testing done after the fact in order to ensure and validate that the outcomes that were expected have, in fact, materialized.

MR. JAMES: Mike, then Edna.

MR. CALHOUN: A couple of comments. First, on the big picture, I think what we have seen in the credit card field is what we should have expected in that there were very few rules and, as a result, companies ended up competing in some ways that were neither good for consumers nor very efficient or very helpful for the overall economy.

Two of the main ways, and we've talked with a number of the credit card issuers, including some in the room, is they fight to cannibalize each other's book of business by offering introductory rates that are too good to be delivered.

They can't afford, if everyone actually realized the benefits of those introductory rates, to offer them. But there are no rules that prevent their competitors from gaming their introductory offers, and so therefore to meet those introductory offers they then match the gaming techniques that their competitors do. It just doesn't seem that we would want a regulatory system that encouraged that to be the focus of the competition, rather than who can best underwrite their customers, who can most efficiently provide the services.

Then the other main way the competition developed was who can pick up these various fees and maximize the fee revenue, because it's very hard to shop or avoid the fees. We saw the gaming of posting dates, et cetera. If you're a company and you're competing against someone else who is doing those practices, it's very hard to ignore those and say, I'll take the high road, but my credit card is going to look more expensive. My introductory offers are going to look less alluring. I would suggest that the role of the Fed is ideally situated to be that referee, to help direct the competition towards direct competition on the merits and also transparency.

The credit card industry went, I think, the opposite way on both of those, and I think their analogies to the debit card overdrafts are very similar. You've seen an explosion in the revenue there, which is very hard to explain. We released a report recently that revenue on those overdraft fees is up 35 percent in the last two years alone and it's still on a rapid climb.

So, just a couple things real quickly. I think it's important on the credit cards that it included not just opt-in but opt-in and substantive protections. We assume people opt in, choose transactions. The fact that you choose to get a loan doesn't mean that there should be no substantive protections at all. Usually, we assume that people are voluntarily entering into a transaction, and that's taken for granted, not that that is the only consumer protection in place.

I had a couple of just minor points on the over-the-limit fees. There are some issues about whether they can be applied due to a credit-line reduction. We trust that that would not be grounds that would generate an over-the-limit fee.

There are concerns in context to this public relations campaign that if people opt out, they need to understand that they may be opting out of the coverage, but they can still suffer adverse consequences if they, in fact, go over the limit through some other transaction. There are going to be technical issues there. I don't know what we're going to do with the hold problem, the authorization problem that we went through -- a debit that goes in, for example, for a restaurant, and there may be a delay, so you may have some over-the-limits that are inadvertent. I hope the rule takes care of those kind of technicalities.

But the big picture, I think, here is that we have an opportunity. We're late down the curve on overdraft fees to avoid this same thing.

I think the other lesson is I hope that the Fed gets out in front of this. We've talked about scalpels and machetes, and the folks down the street sometimes swing a larger knife less carefully. I would hope that the Fed would be the one who could delve into this and solve the overdraft issues.

MR. JAMES: Edna.

MS. SAWADY: Thank you. I'd like to clarify my perspective on the under-21. By no means did I intend to say that kids in college need to run wild with all their credit cards.

Of course, we need to make it harder for the irresponsible use of credit. Of course, we need to make sure that we don't use silly trinkets to get people into debt without their full consent, and I'm very glad that we have a whole set of provisions limiting such activities.

At the same time, I'd like to also note that our financial system is based on people, young people, getting credit slowly. We all know the problems that people have with no file and thin file and everything. Their ability to accumulate assets is hampered by not having credit. As much as we have a responsibility to protect the young kids from irresponsible use of credit, we also have a responsibility to help the responsible users of credit to get it gradually.

Income verification -- I didn't mean to say it's bad. If we want to undertake it, it's fine. I just don't think it's very useful in the long run. Especially in this economy, income that somebody has today is no good tomorrow or on Friday, and on Monday it could be totally different.

There are things that can and should be done, like starting kids very slowly, starting them with a very low threshold at the beginning, monitoring behavior, monitoring repayment patterns, fully informed decisions to undertake credit, mandatory educational workshops.

I think there is a lot of work that can and should be done, not necessarily technical procedures but really a concerted effort on consumer education in how we get new entrants. It's not only kids under 21. I think my comments go for all new entrants into the financial system, whether they are immigrants, people who have no credit in the past or any other new entrant into the system.

MR. JAMES: One more?

MS. HASSON: Edna, I agree with your comments. I think one of the things that hits me hard is when I go around and I meet somebody who's 24 years old, I almost hate it, because what the inevitably say to me, a lot of them who didn't get credit cards, is, I did the right thing. I didn't get a credit card in college, because I didn't have income. Now I can't get a credit card when I have a job, because they're telling me I have a thin file.

There is something wrong and broken with the system, and that's why I have such passion about this issue. We're giving cards to people who don't have jobs, who are in college, who are just incurring debt, yet those who are entering the system and for the first time get that job --

We have great car programs out there for first-time college graduates. We don't have great first-time credit card programs for college kids, graduates of college. I think there are ways the industry can address it.

Trying to grab them in college when they don't have income to me is just, it's also masking the cost of college. Most of that money is being used to pay for books and, I'm sure, other incidentals, but it's masking the cost of college at 18 percent and supplementing college costs.

MS. SAWADY: I think we are --

MS. HASSON: That's why I feel such passion for it, because I think we're not looking for solutions as an industry. We're taking the easy road of giving it to them in college.

MS. SAWADY: I don't think we're taking the easy road, and I think we do agree that we need very well thought-through programs for college kids, so we agree on that. We want to make it easier for the responsible users, very hard for the irresponsible users.

I don't want to repeat what I said before, but I do come across the first entrants to the system, whether college kids or others, and they are struggling to get the car loan, to get anything else. So I think we need to be careful to balance the two extremes.

Andy, you will correct me if I'm wrong, and Kevin, but I don't think we're running around -- there are some irresponsible card issuers who would do that, and we need to stop it. But in the mainstream, I don't think people are running around giving cards to people who have no income whatsoever. We're talking about stated income as opposed to verified income and all this good stuff.

MR. NAVARRETE: I will be extremely brief with this comment, but I think this was the critical debate a year ago. It really, I think, is a bit outdated as a debate today. The fact is that the Credit Card Act, in combination with the Fed rules and then with the overlay of the economic downturn, has shifted this dramatically.

We now have significant restrictions on marketing of credit cards to 21s, so I don't think the question in the future will be the willy-nilly issuance of credit to people under 21 or to college students. That's not to say it wasn't a problem, but that problem was precisely why the Credit Card Act was enacted.

These were the complaints that people were hearing, and that is why Congress and the Fed are acting. I just wanted to make sure that everybody sort of understands just how comprehensive these changes are. The fact is that the industry will adjust to the new marketplace, will adjust to people coming out of college without the same credit history, positive credit history in many cases, that came out of those programs. They will then have to look at new-to-credit for the 22-, 23-, 24-year-olds in a very different way. I can assure you the market will adjust.

MR. JAMES: Back to you. We're out of time.

MS. SAWADY: So after this -- in some way, I wish that we had flipped the order, because the last item is really a sad one. It's the foreclosure item, and I hope there is some good news around it on the fringes, being the last item on the agenda, but it is a very heavy topic.

The number of homes at some stage of foreclosure is continuing to increase amid rising unemployment and despite efforts to help borrowers save their homes. In the third quarter of this year, there were foreclosure filings nearing 1 million. It's an astounding number. The exact number is 938,000 properties, an increase of 5 percent from the second quarter, according to data from RealtyTrac.

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, the differences between the temporary modifications and the permanent ones, and other issues related to foreclosures, including some of the REO disposition issues that really got a lot of lively comments.

At this point, I'd like to call on a member of the Council who we did not have an opportunity to hear from yet today. Patty, back to you.

MS. HASSON: Well, I think there's plenty of experts in this room who can talk on the foreclosure issues and what they're seeing, so I'll try and be a little bit quiet.

We did have a great discussion, and I just want to emphasize we did talk about fair-lending issues at the first part of our meeting yesterday. Carol Evans did a great presentation. I think everyone here looks forward to more follow-up around the fair-lending issues associated with loan modification.

However, most of our discussion in this next half hour is really focused on the foreclosure issues and what's happening under Making Home Affordable and loan modifications. With that, I'll turn it to Kirsten.

MS. KEEFE: Great. I also do want to just say thank you for the report on fair lending and continuing to keep the focus on the foreclosure crisis being very much a civil rights issue and that there are many economic and practical reasons why we need to help folks get into loan modifications. At the heart of it is we have to right the great wrong that we did of not providing adequate protections, especially for a lot of our minority communities. I think it's wonderful that the Federal Reserve is proactively trying to anticipate fair-lending issues through the loan modification process because advocates, of course, are concerned about that as well.

I do always seem to be the voice of doom and gloom at these meetings. Unfortunately, I think the reports that were contained in the materials seem cheerier to me than the reports that exist on the listservs and on the conference calls that I have been part of, both within my own state but also nationally, consisting of housing counselors and primarily legal services lawyers who are continuing to work directly with homeowners.

There continue to be multifarious issues with HAMP. Customer service, I think, continues to be a primary concern. Folks can't get through and are sending documents, and the documents are getting lost and having to resend documents. Those issues continue to be a big problem. That's not to say that I don't have sympathy for the servicers and the volume. It's just a statement that we all need to be doing better for folks who are really in dire straits and about to lose their homes.

The biggest emerging problem that I've heard of in the last month or so has been specifically an issue of going from the trial loan modifications under the Home Affordable Modification Program into a permanent loan mod. There seems to be, first of all, great misunderstanding among consumers. I think folks thought that if they were getting the trial loan mod, and if they made the three payments under the trial loan mod, they would automatically be qualified for the permanent loan mod.

That is not, in fact, the case. I think right now we're in a period of maybe that will be the case, but a lot of the servicers are asking for more loan documentation -- more documentation of the homeowner's income, even if full documentation was provided at the time of application. Then there are further delays in actually getting the permanent loan modification. So that seems to be the biggest problem that we've seen.

Then the second biggest problem that I think I've heard about, and Mike Calhoun mentioned this at yesterday's meeting, is the fact that foreclosures are continuing to be filed even pending consideration prior to the trial loan period by the lender. They're being filed while someone is in a trial period, which, in my reading of the HAMP guidelines, violates the HAMP guidelines, but it is still happening.

When a foreclosure is filed, at least in my home state of New York, that means an automatic addition of $2,500, and even if it was wrongfully filed and the person shouldn't have to incur those fees, you'll have a hard time arguing with your servicer to take off those fees, even if it was all done in violation.

MS. HASSON: Okay. Terry?

MR. THEOLOGIDES: Thanks. Yes, we had a good discussion. I can lend the experience of my firm as a servicer. I think I'd say the news about HAMP is mixed. It's not all negative, not all positive.

I think, on the positive side, some momentum's really been developed about the trial mods, and I think they've crossed the half-million mark in terms of trial mods initiated, and that means that substantially more than that number were evaluated for trial mods. So in terms of being able to mobilize communications among servicers and homeowners, to the tune of hundreds of thousands, that's not something to be dismissed.

The other good news is that most of those trial mods are making most of their payments, and most of them are providing most of the required documents. The bad news is that the HAMP is, for obvious reasons because it involves the public treasure, is very strict, and so they have to be making all of their payments, and they have to be providing all of the documentation.

I think now, because this was put together so quickly, servicers who are now operationalizing it are communicating some of those difficulties that maybe even they didn't anticipate. So income documentation, things are missing, or there are inconsistencies with the hardship affidavit or with tax forms, for the most part benign -- just it's a lot of paperwork, but there is a pressure to dot all the i's, cross all the t's. And so many of those loans are requiring multiple communications with the homeowner who, as Kirsten mentioned, some of them believe, "Hey, I'm in my trial payment. I'm making the payment," and it's been a little more difficult sometimes to get that channel of communication for the second or third round of discussions connecting.

The economic environment is also affecting many of the trial mods. What was their income during the inception of the trial mod may not be during the period, and so some are falling out just because they can't quite make the payments, even though at that point in time maybe they could.

I think the result is going to be in the short term that the pull-through rate is going to be in the next couple months is going to be lower than what everyone aspires to. That doesn't mean that all those folks are being turned down. That means they're still in process.

I guess the good news or the silver lining on that is very recently there have been some what I'd call surgical and very pragmatic relaxation of certain elements of the documentation requirement that really were of maybe marginal benefit. On the one hand, that's a lot of extra work to go re-underwrite everything under those new criteria, but once those have flowed through the system, I feel like this program will gain traction and that by early next year you're going to be seeing final mods under the program coming through in significant numbers.

The other thing I'd point out is for many of these homeowners, even if they fall out, the fact that this program fostered communication, got them re-performing at a level that's affordable, they will be channeled into non-HAMP mod programs. Nobody gains anything by taking somebody who's been able to re-perform at a lower level, has engaged, has provided some documentation, is committed to staying in the home -- if they can't make the documentation requirements at HAMP or slip a little bit on the payments, I think everyone's interest are aligned in moving them into a non-HAMP. I think when the data is reported about HAMP, we need to recognize the broader impact out of the penumbra that's flowing from this program and not just the pure numbers of what's pulled through under the highly stringent requirements of the program itself.

MS. HASSON: Jim?

MR. PARK: Clearly, the industry has had quite a bit of challenge in kind of implementing HAMP and MHA, and the servicing industry was not set up to deal with this kind of volume, clearly. I think everyone was shocked to see the kind of volume coming through, although Mike Calhoun, actually, I think, predicted this a few years back. But no one listened, Mike -- I don't know why -- in terms of the level of delinquency.

Clearly, even with some of the challenges in the industry kind of ramping up the systems and kind of misdirection from the start around some of the requirements and so on, I think people have done an admirable job of getting this up and running. I would say I think everyone applauded Terry and his team at Saxon for being sort of at the top of the list -- in the top quadrant? Was it top?

MR. THEOLOGIDES: At the very top.

MR. PARK: At the very top. I think that kind of spotlight on good performers is great, because I think it kind of incites competition and gets people like Terry and his colleagues at Saxon recognized.

We also know that some companies are not doing so well, and the challenge here is that this is an issue that has a limited time frame for where we can actually create a solution. This is a problem that's going to last for two, three years, we hope. We cannot wait for certain servicers to figure this out in two to three years. It'll be way too late. I think one of the discussions we were talking about was how do we -- I know this gets into contract issues and other things around pulling servicing away from people who are not getting the job done and force placing it with other servicers or sub-servicers who are going to do the job right in a shorter period of time. It's clearly a longer discussion to be had. It's not an easy solution. But it's something that I think we have to look at over time.

MS. HASSON: Shanna?

MS. SMITH: I'd like to say I think it was really valuable having Carol Evans and her team here and going over the GAO report. It's very useful to have more information about the loss mitigation activities of the Fed in the fair lending context.

Perhaps, as these reports continue to come forward, we would be able to look at by census tract race and national origin of people who are getting loan modifications, where they're happening more quickly. Is there an impact based on the protected classes under the Federal Fair Housing Act?

The other thing that I mentioned yesterday that I would like the Fed, in not just the fair lending examination but on safety and soundness and CRA issues, to look at the disposition of the REO properties by the lenders and how many are going to owner-occupied versus being pushed to investor. Also REO property maintenance -- we're looking now at how servicers are maintaining properties in neighborhoods of color in comparison to what they do in the suburban white neighborhoods in the maintenance of those properties.

Two other issues are we're finding that foreclosures will happen, but the lender doesn't record the foreclosure in a timely fashion, so the homeowner remains liable for taxes, maintenance, and any penalties from the community, the municipality.

Another issue we're uncovering is foreclosure abandonment. We're finding that lenders are giving notice to homeowners, the homeowners are vacating the property, and then for a variety of reasons, some we've heard that their asset management providers or other real estate advisors in the community say to the lender, "You're not going to be able to sell this property, so you should just stop the foreclosure."

Now that would be good if I was still living there, and I knew it, and I could still make a payment, but this is happening to homeowners who have left. Now they are responsible for the taxes, the insurance, the maintenance, and the cities are coming in, boarding up the property, mowing the lawns, issuing penalties against the homeowners.

You may or may not have seen the CNN report in August about an African-American couple, I believe in Buffalo, who were waiting to see if they were going to have to do jail time, because the lender received judgment, foreclosure judgment, and failed to file or record the deed in the bank's name. What we're seeing is this is happening in communities of color, as opposed to suburban white communities and, as the Fed knows, that's a fair lending issue.

If we could still have Carol Evans's team come in and help us understand, particularly for the housing counselors if they're running into situations where they recognize that people with disabilities that they're counseling, people of color, single female head of households, incomes where there is not a dual income in the household, those mortgage modifications aren't moving, or the terms and conditions are more restrictive, for them to understand those could be Fair Housing Act violations and should be reported not only to the federal regulators but to the Department of Justice.

Finally, I'm hoping that the bank examiners, the CRA officers, and the safety and soundness people will follow the litigation that's being filed by the Department of Justice and in particular what we're learning in the Baltimore, city of Baltimore case.

MS. HASSON: Patricia, Kathleen, and Kevin.

MS. DUARTE: We all know that loss mitigation is a very difficult thing to do, and it's a case-by-case situation. The hardest thing was to try to solve the problem with one brush. HAMP came around, announced in February/March with the guidelines, and it was a really great attempt to try to make a standard set of guidelines, and hopefully the lender-servicers were going to abide to that.

So it's working. We are seeing some progress in Arizona, and we do see some of the same challenges that Kirsten mentioned earlier. But the sooner and the closer we can do and whatever the Fed can help with to bring more uniformity and automation would be so helpful.

The guidelines for HAMP were detailed, but Fannie Mae, Freddie Mac, FHA, they all have differences. They have taken the guidelines and yet have stipulated different things in their guidelines. That makes it just more confusing for the lender-servicers and for the families. So do they have a Fannie Mae? Okay, they will do this, but Freddie Mac won't. That is problematic.

So whatever we can do to automate one standard uniform application would be great. They all have different applications for evaluating this type of assistance, and so the inconsistencies are just very stressful, and the work is increasing. We are seeing more and more people in need of loss mitigation in Arizona, just like the rest of the nation, and unemployment continues to be the worst problem for us.

MS. HASSON: Kathleen?

MS. ENGEL: I want to just talk for a minute about the problems with modifications on properties that have second liens. I'm concerned about the fact that banks were engaged -- not all banks, of course -- but in these 100 percent LTV products where they would have a first [loan] of 80 percent to 90 percent and a second [loan] that would make up the difference up to 100 percent, 120 percent piggyback. They would typically sell the first into the securitization market and often would retain the second in their portfolios.

Those seconds are now worth nothing. They definitely will be worth nothing if there is a foreclosure on the first, because the homes are under water. But despite this reality that these seconds have no value now, and certainly won't have value once there is a foreclosure, the banks are holding up modifications. This is somewhat cynical, but I think it's right, that they're waiting to see whether the government is going to provide them an incentive so that they will at least get something out of these liens, which have absolutely no value and little hope to ever gain any value.

I understand there are balance-sheet concerns for the banks. But those balance-sheet concerns are not going to go away, because these loans, the firsts, if they don't get modified, then there is going to be a foreclosure, and ultimately the holders of the second are going to have to record the losses.

I really hope that the Fed is able to impress upon the banks the importance of not being short-sighted in this, that holding out so they can get something out of nothing is a mistake relative to the larger cost to the economy of not having these modifications. The lenders were the ones who made these risky loans. They made a bad choice. They now have to eat these losses.

MR. RHEIN: I guess a couple points on that. I think this is a great example in this second mortgage modification program of a disconnect between, perhaps, being consumer-friendly and prudential examination around safety and soundness.

Under the HAMP guidelines, if there is an interest-only first mortgage, and there is a second mortgage, you would also potentially have to do an interest-only second mortgage modification. Yet the regulators have said in those circumstances you would completely have to write off the second mortgage balance -- not a partial, but complete write-down. So we and many other large second mortgage lenders have said that's just not acceptable.

I guess, Kathleen, when you look at the value of a loan, it's not just the collateral. Frankly, you rarely want to go to the collateral. You're looking at capacity. You're looking at character. You're looking at prior credit history.

These loans are not worthless, and it would be totally a travesty and inappropriate to have a massive write-down on a lot of these second mortgages, irrespective of whether they are upside-down or not from an equity perspective.

Understand, 90 percent of our mortgages today are current. Ninety-two percent, actually, of our mortgages are current. If you were to look at the second mortgage portfolio, you probably would see similar statistics.

So you've got a massive inconsistency between what the HAMP program is requiring, which is do these, and how the OCC is looking at how they're going to cause a reclassification of those assets. There is a way to solve this. I think you guys provide direction to the regulators in this space.

The second thing, a little bit on what Patricia said, and Terry has mentioned this before, there are thousands of people that have been added to the ranks to try to deal with these. We've added 13,000 employees in Wells Fargo Mortgage to try to do this stuff.

To the point of FHA's got different guidelines than Fannie, that's got different guidelines than Freddie, and they're constantly changing, you're constantly having to retrain, so I can understand why there is mass chaos when counselors are calling and all these things are going on. Streamlining, efficiency, standardization -- if there is a way to get the agencies to work together and stop the nuances, I think you'd see far more through-put and far better service. We've done a lot. We know we need to do a lot more, and we're just working as hard as we can at it. People are killing themselves trying to help in this space. Thank you.

MS. HASSON: Okay. Kirsten, and I think we then have to wrap up.

MS. KEEFE: Just one more thing about the second lien program, and this sort of speaks to something that Terry said about if somebody doesn't qualify for HAMP, you're still going to look at them otherwise. You might, and I don't hear many complaints about Saxon, but other lenders aren't.

I just had an example this week where someone didn't qualify for HAMP. They have a first and a second, and actually both are serviced by the same servicer. They didn't qualify for HAMP because the current mortgage payment is over the 31 percent debt-to-income ratio, but then when they were pushed into the regular loan mod program of this servicer, they did not qualify, because when you took into account their second lien, their debt-to-income ratio was too high. Again, it sort of speaks to there are still a lot of quirks in the system.

But the one thing that I wanted to end on is an encouragement, if the Federal Reserve could slip advocates the net present value (NPV) test or somehow encourage Treasury to make that publicly available. Advocates that I work with are still using the FDIC loan-mod-in-a-box model that is publicly available just to give a ballpark to see whether or not the homeowner could potentially be getting a loan mod.

On the back end, when people are being denied, it's sort of the same conversation that we had when we were talking about HELOCs and lines of credit being retracted. Folks aren't being given reasons why they're denied the HAMP loan mod or why the failed the NPV test, and there is no appeals process. Freddie Mac hasn't yet developed a meaningful compliance process or appeals process for homeowners. So folks are just being categorically denied a HAMP loan mod with no understanding, and again I think that dovetails back to some of the fair lending concerns that were raised yesterday and Shanna echoed today.

Also, folks are still hearing a lot, "The investor won't allow it," and again without any meaning behind that blanket statement. I think a lot of folks just wonder if that's more of an excuse than anything, if really there are that many investors that are still denying HAMP.

MS. HASSON: Okay. Thank you. I do want to end on an up note. We had a great program recently with Chase, which actually worked with Fannie Mae and our agency to do some outreach directly to clients, and it was very successful. I know Patricia told a very similar story about her experience with Wells.

I would encourage the Fed to encourage these institutions to think about this proactive outreach with agencies where they can get the information directly with the borrowers. It works, and there are proven models out there, and they need to be doing more of those. Edna, it's back to you.

MS. SAWADY: Thank you. Well, we are nearing the end of the formal discussion points, and at this point we added another exciting opportunity for Council members to speak out their minds. We will have an open comment session for all the CAC members. At this time, I will call on people who would like to make comments and ask them to make them brief and also just remind everyone we're talking about subjects that were not discussed during today's session.

So it's an opportunity for Council members to raise their opinion and give their advice on any matter that they find appropriate that has not been discussed during the more formal part of the agenda. So, to kick us off, Luz?

MS. URRUTIA: Yes. First of all, as a departing member of this committee, I would like to again commend the Fed and the staff for the excellent work that has been done, from my perspective, in the last three years in getting together all the presentations that we have been asked to comment about.

On behalf of the consumers that this committee represents and the practitioners that provide such critical financial services, we would like to encourage the Board staff to provide some financial information and projections in the proposals that they present for comment.

Clearly, all of these regulations that are being considered and those that have been enacted are having significant financial impact on both the consumers and the institutions that are providing the services. In an environment where both consumers and financial industry are being significantly impacted at the bottom-line level, now more than ever it's important for this Council to have all the necessary information, to include financial information, so that we can be better equipped to make these decisions.

MS. SAWADY: Thank you. Patty?

MS. HASSON: We had a robust conversation yesterday on the [Consumer Financial Protection Agency], and I did not weigh in on the preemption and won't do that. I'm sure at another point someone else will. But one of the points that I wanted to bring out was that my concern is not so much where that agency is placed or the preemption, but the ability to act quickly. I use the example of when there was tainted dog food. It was about 1 percent that was tainted. We were pulling dog food off the shelves, and we were in a panic as a country. Yet when foreclosures were starting to rise and delinquency on people in subprime mortgages, we were debating what rules, what regulations they fell under, how we could stop them.

I just feel strongly that we need to be thinking about, whoever has this authority, that they're looking at consumers, that they have the ability to act quickly and stop a practice that on its surface looks predatory or wrong.

There are many of those practices out there. I recently received a debit card, unsolicited, in the mail. That's just wrong. There are going to be people getting those cards who don't know what they are. They don't know what the fees are. They don't know how to use them. It should be stopped. Then if the financial institution or the entity wants to make their case about why that is a proper practice and what information they should be required to disclose, it can happen.

There are financial institutions and some of their subsidiaries who are engaging in payday lending, rent-to-own, [refund anticipation loans]. It should be stopped until they can show that the practice they're doing doesn't violate individuals' rights or unfair and deceptive practices.

So I would just encourage you to think about that, because I think people get hurt while a lot of debate goes on about how we can fix it.

MS. SAWADY: Thanks. Andy?

MR. NAVARRETE: Actually, I will take the opportunity to talk about preemption with the full acknowledgment that it's a bit of an unfair point to be raising in this context, because in many respects I think the Board's hands are tied, and the future of consumer regulation is in the hands of Congress.

Notwithstanding that, though, I'd like to urge the Board to continue to make the case for national uniform standards and to provide whatever data it can muster to make the case for not only the economic benefits of this uniformity but also the consumer benefits of the uniformity.

Historically, the preemption discussion was largely about preserving competition and breaking down barriers in balkanized systems. The telecommunications industry is a great example of this. When we had significant state regulation, it was virtually impossible to set up nationwide networks, and incredible innovations like mobile telephony were largely hamstrung as a result of that.

When those barriers were broken down and a federal preemptive regime was put in place, we had an explosion of wireless service, massive reduction in cost, and massive improvement in innovations in that space, to the point now where a mobile phone seems to be used for just about everything but actually talking to another human being.

So I would urge the Board to look again, sort of economically and from a consumer perspective, at how that same story could be told in financial services. Unfortunately, throughout the crisis that's taken place in the last year or so, we've lost the fact that the system in many respects works exceptionally well for consumers and has brought the price of credit down.

That's not to say we don't need more consumer protection. We actually believe that we need more consumer protection and more focus on it. It's just that we believe that that ought to be a national set of uniform standards, universally applied, and consistently enforced across the entire industry, bank and non-bank.

MS. SAWADY: Thanks. Kirsten?

MS. KEEFE: I'd just like to say I agree with that point, but I think it should just set a bar, and then states can provide additional protections.

One thing that I actually forgot about in thinking about the new issues to bring up until Kathleen was starting to talk about the second liens -- they are profiting from these second liens. They are now selling them to debt buyers. I forgot about this, and we had some e-mails last week in New York about this.

I would urge the Federal Reserve to start watching that. You know, debt buying has become such a huge industry in the country. We are starting to see lenders sell these second liens to these third-party debt buyers and collect directly against folks, obtaining a judgment against them, and then starting to garnish their wages, which is obviously going to impact their ability to make the loan modification payments on their first mortgage. I think it would be really great if we could start to be more proactive in looking at that.

One other new issue that I wanted to bring it up, and I will recognize that Treasury has been looking at this, is the effect of judgments on bank accounts that contain exempt income, income that's been federally and, in some states, protected by statute from collection of debts such as Social Security, SSI, SSD, and public benefits.

It is a huge problem in New York. We did pass a law last year, but we are having awful compliance problems with the national banks. But Bank of America is, in fact, closing the bank accounts of folks that have SSI or SSD income when a restraint hits. So there is going to be an awful impact as the federal government has really pushed people into bank accounts for the direct deposit of these funds. Now we're seeing a backlash where the folks aren't going to have bank accounts and the impact on them, so that's just another issue I wanted to bring up.

The final thing I'll just say, two words: reverse mortgages. We need to start addressing them because I think that's another area -- I wouldn't say new abuse, there have been abuses -- but growing abuse.

MS. SAWADY: Thank you. Kevin?

MR. RHEIN: Thank you. A couple things. The Credit Card Act has got a couple of changes coming up in August, so kind of fast forwarding to things that the Fed is looking at doing, refining some of the regulations around future changes. Two things we would encourage you to keep in mind.

The first is the six-month reevaluation. If there had been a pricing increase, do you need to go back and undo that pricing increase? I think the biggest thing that we would ask the Fed to think about is, how are you going to do that and evaluate it? It shouldn't necessarily be that the single factor that caused you to increase it should be the only reason that you would have to undo the increase.

So, for example, right now losses are very high. Many issuers have raised rates to try to compensate for losses. The real key should be what is the ultimate profitability of the business. So there could be other factors that will come along that will be a challenge to the business, so in order to give back revenue, I think it's important to take a look at what's the performance of the business overall.

For example, down the road funding costs will be dramatically higher than they are today. It may be that as losses have dropped, funding costs have gone up. We're really not any better off if we have to start to reverse some of the rate increases. It's going to cause a further contraction of credit. So that's one area.

The second would be the proportionality question of fees. One of the things that we think is just very important is when you look at how proportional, are the fees reasonable and customary or proportional, it's not just the cost. It's the loss factor. We can certainly demonstrate that certain behaviors are riskier, and you have to look at not just the cost of the fee but also how that plays into the risk factors and the ultimate performance of the account. There is also a deterrent factor that goes along with that, so we'd just encourage the Fed to be fairly broad in its thinking about how it's going to define those standards.

MS. SAWADY: Thanks. Tom?

MR. JAMES: Yes, I wanted to kind of alert the Board and staff to an emerging problem we're seeing, which is point of sale, sale of credit, in these cases credit cards and credit for medical services and devices. This credit is often -- it's the provider who has got an affinity relationship with a doctor or some other medical provider, affinity relationship with the patient, and is suggesting a credit relationship through a third party. I think that's a big emerging issue. Lori Swanson, the Attorney General of Minnesota who used to sit on this Council, filed a suit very recently on that, and we see that coming along.

Also, live checks -- we've still seen those going out from large financial institutions to induce people to cash them. They turn into a revolving credit account that typically turn into -- well, I don't know what their trajectory is anymore, but they used to turn into a secured credit relationship. But, anyway, that kind of marketing device is still happening as recently as weeks ago. I was kind of shocked to see it, but it's out there.

On preemption, I won't bother you. But I will say that whichever way it breaks, certainly people in my position, who are line prosecutors who do take on garden-variety cases and end up with very major cases, always look to institutions like this for backup, any way, shape, or form. I think every prosecutor out in the country who's in over their head fighting the good cause has to be able to rely on the resources that institutions like the Fed can provide.

MS. SAWADY: Thanks. Kathleen?

MS. ENGEL: First, I want to just thank the Fed staff and the Board for so carefully and thoroughly taking on some of the thorniest issues in consumer credit. I know that people up on the Hill are working very hard, but you all are getting things done, and it's great.

I have two sort of credit issues that I wanted to raise. One is the increasing use of prepaid debit cards, which are really a loan from the consumer to the bank. I mean, it’s really how they function, but some of them have incredibly high fees.

For example, one I looked at had an application fee of $100, and this is a loan from the consumer to the bank. Another one had a $10 activation fee, $1.75 charge per withdrawal, $1 for each balance inquiry, 50 cents for each purchase, $4 a month maintenance, a $2 inactivity fee if there were no transactions for 60 days, and $1 charge for every call to customer service. These are loans from the consumer to the lender.

The second thing, and some people may have seen that Inspector General's report that just came out on FHA and HUD review of FHA lenders, but there has been a movement among some of the bank holding companies to buy FHA lenders. They are refinancing loans on their book into

FHA products. I'm concerned about the shifting of private-sector risk onto the public-sector through that model. I don't even know how the Fed intersects there, but it seems like it's an issue of some importance. Thank you.

MS. SAWADY: Thank you. Joe?

MR. FALK: I hope that the Fed fosters small business participation in financial services. I think that small business plays a very important role, fosters entrepreneurial activities, local businesses, local employment. That's not to say that there isn't a role for large business. I like large businesses, too, but there is a place for small business financial intermediaries to provide an appropriate competitive stance to keep prices low for consumers.

MS. SAWADY: Thanks. Mary?

MS. TINGERTHAL: Yes, thank you. I want to raise an issue that may strike many as not being a consumer issue at all, but I'd argue strenuously that it is.

I want to urge the Fed to really take a leadership role now in articulating practices that emerged in the securitization market that are now having an impact on consumer credit and in communities. An example of that -- it may be a very small example -- is the fact that right now the practice among trustees in whose name the title to a property of a securitized loan is recorded really have no obligations to keep any records electronically on the mortgages for which they are trustees. So, literally, it is a paper chase, if you can get the trustee to do it, to find out who the servicer is on that mortgage. I'll just give that one example.

I would just say that I think that the Fed is in a unique position, having been cast in the role of this systemic risk overseer and with the Chairman having articulated the importance of a macro-prudential approach to supervision and regulation, to really take on this task and shine the light of day on a list of practices that need to be addressed.

It's not that the Fed can address all of those, but to shine a light and say to the various parties, the regulators, the SEC, and others, "These are things that we can address without legislation but through either regulation or change in practice that can really save us from having to go through the same things again."

The Fed has been one of the loudest voices, personally, I think, positively, for the fact that our current financial system really needs securitization in order to bring together long-term investors with long-term borrowers that has to be intermediated in order for that to happen. With all the ills of securitization, the Fed really did step up pretty quietly and started buying the securities produced by Fannie and Freddie, I think to the benefit of an awful lot of consumers in this country.

I think the Fed's in a unique position to take this leadership role, and I would hope we would do it quickly while we are in the midst of discussing financial reform. Thank you.

MS. SAWADY: Well, thanks to everyone for your thoughtful comments. Now we are turning to brief reports on work that the committees have done that did not get included in the formal agenda. The Housing and Community Development Committee -- Patty chairs this committee -- discussed some fair lending issues if you want to comment on them just briefly.

MS. HASSON: I think we covered a majority of our committee today, so I don't think we need to add.

MS. SAWADY: Okay. Great. Special Issues Working Group, Mike, you want to comment on that?

MR. CALHOUN: Yes, so there are three sub-groups working in that area.

The first one that Ira is heading up is looking at CRA issues, and we had a good discussion. I think we found that there was lots to talk about, not surprisingly. I think there was the recognition that the issue may be with the Fed and with the regulations longer than may have been expected at the beginning of this year. As is often the case, the legislative process is slow and uncertain these times. But they intend to have additional work and some recommendations that they hope that they can bring back and see if we can reach consensus on narrowing at least the issues.

The second group was headed by Kathleen and Saurabh and looked at data collection, trying to get a better handle on what data is collected. I think there is consensus that empirical-based regulation is the desired course. There were some cautions raised by Kevin about the cost and imposition of more data collection, so there is certainly a balancing there. But they also worked on a white paper to bring back to make some recommendations.

Finally, Ron Phillips has been helping on small business credit, which I think continues to be a persistent problem that gets some coverage and some attention but not much in the way of solutions yet. They are looking at a number of issues there to bring back again with a white paper to look at.

One specific issue that he worked with Andy on a preliminary basis is to look at credit cards and are there some just basic provisions of the Credit Card Act that would be appropriate to be applied to commercial small business cards as well. One example is the 21-day billing cycle, for example, to provide some standardized protections there, recognizing that that's a critical line of credit for small businesses.

MS. SAWADY: Okay. In closing, I'd like to thank everyone for their participation today. As always, it has been a lively discussion with a range of opinions, and it's just great. We'll now adjourn. Council members are invited to lunch on my right-hand side, and thanks to everyone.

(Whereupon, the foregoing matter was adjourned at 12:27 p.m.)