BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CONSUMER ADVISORY COUNCIL

THURSDAY, JUNE 17, 2010

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., Michael Calhoun, Chair, presiding.

Members present:
Michael Calhoun, Chair
Jim Park, Vice Chair
Paula Bryant-Ellis
Joanne Budde
Alan Cameron
John P. Carey
Kerry Doi
Kathleen Engel
Betsy Flynn
Patricia Garcia Duarte
Ira J. Goldstein
Mike Griffin
Kirsten Keefe
Lorenzo Littles
Saurabh Narain
Andy Navarrete
Dory Rand
Kevin Rhein
Phyllis Salowe-Kaye
Shanna Smith
Corey Stone
Jennifer Tescher
Mary Tingerthal
Mark Wiseman

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

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9:00 a.m.

MR. CALHOUN: Welcome, everyone. I'd like to begin by acknowledging and thanking Chairman Bernanke and Governor Duke for their attendance and for their dedication to these consumer issues.

Yesterday, we had quite a packed and lively session, which I think reflects the activities and the issues that are going on today. The first item that we undertook was discussion of the Home Mortgage Disclosure Act, as we all know affectionately as HMDA.

The Board is looking at comprehensive review of Reg C, which implements the Act, and requires mortgage lenders to provide detailed data about mortgage transactions. I'd like to start by turning over to Sandy Braunstein, Director of the Board's Division of Consumer and Community Affairs for some comments on activities that the Board has in this area.

MS. BRAUNSTEIN: Thank you, Mike. I just wanted to reiterate what many of you already know, which is that the Board has announced that it will hold four public hearings beginning in July on potential revisions to Regulation C, which implements HMDA. These hearings will take place in Atlanta on July 15, the Federal Reserve Bank of San Francisco on August 5, the Federal Reserve Bank of Chicago on September 16, and the final one will be here at the Board on September 24.

We're also pleased to tell you that the Consumer Advisory Council is going to play a key role in these hearings, and they will be presiding along with officials from the Board. There's going to be two CAC participants for each hearing, one as a presider for the first panel of each hearing and another for the second panel. I'd just like to take a minute to acknowledge the members that are going to be participating. In the Atlanta hearing, Ira Goldstein from The Reinvestment Fund and Shanna Smith from the National Fair Housing Alliance. In San Francisco, we're going to have Patricia Garcia Duarte from Neighborhood Housing Services of Phoenix and Jim Park from New Vista Asset Management. In

Chicago, we'll have Kathleen Engel from Suffolk University Law School and Saurabh Narain from the National Community Investment Fund. And for the final hearing here at the Board, Mike Calhoun from the Center for Responsible Lending and Paula Bryant-Ellis from BOK Financial Corporation.

We very much appreciate the time and effort that the Council members are going to spend working with us on these hearings and the value that you'll bring to that process. Obviously, we're also very interested to hear your comments today as we move forward with this rulemaking. Thank you.

MR. CALHOUN: Thank you, Sandy. And on behalf of the Consumer Advisory Council, thank you to you and the Governors for the opportunity to participate in the HMDA hearings. I think as we've done our work, we've been impressed with how the consumer regulation has been data- and research-driven. And perhaps nowhere has that been more critical and perhaps there are some areas for improvement than in HMDA.

With that, I'd like to turn it over to Kathleen Engel, who will lead our discussion that we had about the HMDA issues and the possibilities for modifications to what items are required to be collected on HMDA data.

MS. ENGEL: I want to begin by thanking the Board for taking up HMDA. I think the events of the last two years and the difficulty everybody had predicting them and also trying to regulate in a way that would prevent the subprime crisis would have been enhanced if we had better HMDA data, and it's exciting that the Fed is taking on this issue.

So I thought I might start by having Kevin Rhein talk, because Kevin has a nice analysis of the balancing act that any kind of HMDA reform is going to have to engage in.

MR. RHEIN: Sure. Thank you very much, Kathleen. As we discussed yesterday, one of the things that was mentioned is the need to balance the cost of getting the information versus the value of the information. One of the things I just wanted to urge -- as you'll hear in most of the rest of the conversation, a lot of arguments for more data, more data, more data. And it's extremely expensive. You'll hear about more loan types. For banking institutions in many cases, each loan type, a reverse mortgage is on a different system than a regular first mortgage, which might be on a different system than a second mortgage, and things like that. So the cost is significant.

The other thing I just wanted to urge the Board to think about is the number of regulations and changes that have either already passed or are in the process of being passed to try to understand whether the actions that are contemplated will address many of the issues that HMDA might help. So, for example, there'll be changes to originators potentially having to have skin in the game on securitizations of mortgages. Fannie and Freddie have changed the documentation requirements on loans. There obviously are already fair lending exams that go on. There are potentially more state rights that are going to occur around national banks, all sorts of other things. As you look at the financial reform regulation that's there and the changes that have already occurred, I just would encourage you to balance off whether those controls are sufficient to address some of the things that HMDA might start to surface.

MS. ENGEL: Alan, do you want to comment specifically from your perspective representing smaller institutions?

MR. CAMERON: Thanks, Kathleen. Yes, I do.

MR. CALHOUN: Alan, make sure you speak into the microphone.

MR. CAMERON: Thank you, I appreciate that. I want to urge as you're looking at this issue to go back to the purposes of HMDA and the purposes for the data and, to reiterate what Kevin is saying, to not seek data simply for the reason that that data is nice to have. If it doesn't serve a purpose, if it doesn't serve to correct a misperception that current data gives you, for instance, the racial makeup addition of the telephone inquiry was a good one, in my view. Even though it may be difficult at some points for loan officers, it adds something to the equation. But if it's not something like that, along those lines, and it's simply data that we'd like to have, to me, the costs of gaining that data don't outweigh the value.

I also want to urge that the cost of gaining that data be taken into account, especially for smaller institutions. As you know, I represent credit unions, and most of our institutions don't have the capability electronically to develop this information. As a consequence, much of the information gathering is done manually, and the cost of that is done at great expense in time and money. That burden has to be taken into account.

I would finally urge that we use existing nomenclature, if that's possible. Specifically, the SAFE Act lender designations seem to be a nice fit with the HMDA data collection, so I'd urge you to consider that as well. Thank you.

MS. ENGEL: From the folks who would like more data, Dory, would you like to speak?

MS. RAND: Good morning. First of all, I'd like to thank you for holding the HMDA hearings, and we're looking forward to participating in Chicago.

We think that the HMDA data have been very valuable to us in our research in showing which institutions are lending where, which communities are being affected, what kind of disproportionate impacts are occurring. We use that analysis to help our policymakers in Illinois and our community-based organizations do their work and decide where to allocate resources.

We think that some of the additional data that's being considered would be even more helpful, like the borrower's credit scores, the type of loans, borrower age, things like that. We think that it will help us do our work better. It will flesh out some of the fair lending concerns. Some of our recent research has shown really disproportionate impacts in communities of color, and when we raise these issues with the banks, they say well, we do color-blind lending. If you don't get down to that more detailed data about the credit scores and the type of loans and so on, you can't really figure out what's going on. So, I appreciate you looking into adding some more data and a more thorough analysis.

MS. ENGEL: Do you want to add something to that, Kirsten?

MS. KEEFE: Sure. From an advocacy standpoint, when I look at some of the data elements that are being considered or are up for discussion, or that we discussed yesterday to add, including underwriting, the credit score, loan-to-value, the loan originator channel, I think in hindsight it would have been wonderful to have had that information on the loans, so as we were moving through the crisis, we could have really tailored some regulations, specifically on the state level. That's where I work a lot, and we could have tailored a lot of the remedies going along the way. And certainly looking forward in trying to add reforms to the mortgage lending industry, we would know what practices were existing in these loans, rather than basing it on sort of the anecdotal evidence that is brought to light.

I also think it would be really valuable to have information on loan performance, not just on origination, but as these loans go 30, 60, 90 days delinquent and then move into foreclosure. It's been very difficult to get that sort of information on a state level for me. I think that would be invaluable.

Finally, I think the loan type would be very valuable information to have, whether it's a payment-option ARM or a subprime adjustable-rate mortgage, or what have you. In New York right now, we're struggling with where to direct resources because we know that there's going to be a little blip of the payment-option ARMs now resetting and going into foreclosure, but we have no idea how many payment-option ARMs exist in New York apart from what are reported back from direct service providers. And we have no idea where they are located in New York, outside of pure speculation. It would have been great to have been collecting that information, so that on the state level we would know where to put direct service providers and really direct resources to help those homeowners.

MS. DUARTE: Good morning. I'm also one who would like to add more information to the

HMDA data. In our conversations yesterday, it kind of caught me by surprise that it seems like there's a little bit of information that may not be accurate, the integrity of some of the data going into the HMDA reports. It may not be a large percentage, but the fact that that is happening, it's very troubling to me. I would ask that in strengthening the HMDA, that that is looked at, so that the right boxes are checked.

We talked about how some of the industry, the broker community, would be one to help in entering the data, and currently it is not captured through that particular venue because it's captured when it's sold. But the belief is that that's an industry that can't be retrained. So I think we really need to put more emphasis on making sure the data is accurate.

In today's crisis, I think it would also be helpful to know, of the people who are really struggling, how many of those where perhaps English is not their primary language -- so capturing their understanding of the language and signing a document. I mean, this is the major purchase for most families. When we have a case where they may not understand what they're signing, I think we should look into making sure that the documentation that they're getting into is understandable and they know what they're doing.

MS. ENGEL: Saurabh, do you want to add to that?

MR. NARAIN: Thank you, Kathleen. I want to first start by thanking the Fed for doing the HMDA hearings, and I look forward to participating in the HMDA hearings in Chicago.

The National Community Investment Fund is a non-profit trust that invests capital into CDFI banks around the country. We've done data mining of the HMDA data for the last 15 years in all 8,000 banks in the country and have used the HMDA data to actually help route money into the most distressed markets in the country. We can sort of look at the social performance of one institution versus another. In the process of doing that, we find that there is a lot of data that is kept at the option of the lender to provide or not to provide. That option of providing information on race or on the income of the borrower has limited our ability to actually mine that and reward people for doing the right thing.

I'm a big believer in balancing, as Kevin was saying, the data that's collected, and then using the data for routing money, but also ensuring that the data that we collect can actually be used to provide incentives to those institutions. So I would strongly urge, as we strengthen HMDA, which has been a very extremely powerful Act, that we ensure that fields that are critical to route money into LMI communities are actually made mandatory.

MS. ENGEL: Mike, do you want to talk a bit about what you think would be important to include in HMDA?

MR. CALHOUN: Yes, thank you. First, I'd like to recognize Governor Tarullo and thank him for attending today and for his work on these consumer issues.

The Center for Responsible Lending, we are the more visible part of Self-Help, but we're outnumbered about seven to one, and so on issues like this, we get to hear the push-back from the folks who have to comply with these regulations. I think it's incredibly timely for a number of reasons, the HMDA review. Embedded in the financial reform bill are tremendous changes, as the lenders know, to the mortgage market and to data collection. There is a whole new set of rules of the road for how mortgages will be made. For one thing, it's important to have data to test which of those are working and which of them are counterproductive. So it's an important opportunity to get that feedback and measure whether these new rules are having the effects that are intended.

There are new, large data requirements embedded in the financial reform bill, including performance data that is required to be collected and made public on how loans perform, where are the default rates, and where are the foreclosures. Kevin made the point, and some others did, about the real need to have coordination on that, to have databases that are consistent.

There are privacy issues. Right now, if you patch together from various sources, you can get a remarkable amount of information and eventually track it down to, likely, individual loans. That's a concern, and I know, Kathleen, you spoke to that, and you'll probably have some comments about how to address that.

One particular area that has been a missing part in HMDA has been fee data, what fees are charged with the loan. As a result of that absence, there's always been question marks when you look at whether lending is having a disproportionate impact, because there's always the alternative hypothesis -- for example, that higher rates could have been offset by lower up-front fees. So the fact that a particular group is getting higher-rate mortgages may or may not show discrimination depending upon what fees are being charged in connection with those loans. We would urge to include that data as an important part of the mortgage process. Thank you.

MS. ENGEL: I'm going to take this opportunity to just make a couple of comments about my thoughts about HMDA. The first thing that I think has been a problem throughout the government related to regulating mortgages is that the private sector does a very good job collecting information. They have multiple data sets. I've worked with them -- they're good. And that is what the government has to rely on in determining what's the appropriate policy related to mortgages and to detect any possible wrongdoing by lenders. There are a lot of problems with this reliance on the private data sets. One is that the entities that collect the data get to decide what the fields are, so anybody who uses that data cannot control what data is actually collected, which makes sense. They're buying a service; they're not controlling the service.

The second is that the private sector controls how the data is used. For example, they can put conditions on the use of the data, such as that you can't merge this data with HMDA data, and that's problematic. Thirdly, it's really costly. I don't know how much all the different Federal Reserve Banks have spent buying Loan Performance or McDash data, but I'm sure it's well over $1 million. I think it's $300,000 for each license. On many levels, it's a mistake to rely on private collection of data, and we have to go back to the days where the government collected the data and used it to make informed policy.

The second thing is, I think that we are putting a lot of burdens on regulated institutions in terms of data collection. Part of it is that the different requirements for collecting data have evolved over a period of time. It wasn't coordinated. I would hope that one of the goals of HMDA reform would be to really look at those burdens on the banks and see if there's a way to minimize the number of times and the different ways that they have to produce data. That maybe there would be one production of all of the information through an integrated system. I don't even know how to do the technology talk, but I'm sure it's out there.

We also need to coordinate things like the new broker national registry. That could be somehow, I hope, tied in with HMDA. The performance data that OCC and OTS have collected -- there are already some metrics and models to bring that together. The new performance data that HUD is probably going to be collecting. By somehow coordinating all of that, it seems that we could really reduce the burden on the banks and increase the richness of information that the Fed has to engage in rulemaking and enforcement.

I continue to be concerned about the fact that HUD-1 information is still not entered into an electronic database. The cynical part of me thinks it's a way to evade regulators being able to figure out what the fees really were. But it seems like it's not a hard thing to create some electronic system where all the information that goes on HUD-1s could get entered in there, and then people would have access to the fee information and things like that. I think that's a very important thing we need to do. It's odd to me that HUD-1s are still -- they're not handwritten, but it's essentially that kind of a process.

And the last thing, in terms of the privacy issues, I think the privacy issues are huge for a lot of different reasons. We don't want people to have access to detailed information about consumers because then they could be subject to all sorts of marketing that they don't want. They don't want their next-door neighbor to know how much money they have, things like that. I don't think that that makes HMDA reform and gathering more granulated information impossible.

I think that it would be important to think hard about ways of restricting access to data that the Fed collects, based on what the purpose is. So, for sure, the Fed should get access to all the information that they collect. I assume that probably the Fed would share that information with other federal regulators, and then maybe the next step down is state regulators, and what do they get, and how do they get access? And then researchers.

And then in terms of the public, something less, right? Something that really prohibits or prevents people from being able to detect who the real borrower is, but gives enough access to the data so that people can try to figure out if there have been fair lending violations and things like that.

The model that I suggest the Fed look at is the Census. Of course, the Census has lots of private information about individuals, and people have different levels of access to that information or to more granulated information based on their role and how they're using the information. If academics want to have access to that research, they actually have to go through a process of being deputized, and they have to use the data at -- I think this is still how it works -- at a Census research center. There are controls in place. As we think about the kind of information we want, we should be thinking about what kinds of controls we need in terms of access and thinking about how to reduce the reporting burden on the reporting institutions.

Go ahead, Ira.

MR. GOLDSTEIN: Good morning, a couple of quick points, some of which have been made in a different way. With respect to the HMDA data, there's a couple of things that I think are important. Firstly, the sequencing of the release of the data, the way it's collected, and the timing for which it's released, some of the data are as much as 22 months old by the time they're available to the public and to the regulators for purposes of affirmatively looking through what's in the data and detecting whether or not there are any patterns of concern. So, looking at the sequencing would be an important thing to take up.

Secondly, it's not clear to me why there wouldn't be a way to incorporate data on loan modifications into the HMDA database. Many of the entities that are currently doing the loan modifications are already HMDA reporters anyway. Whether or not it was their loan that they're servicing and modifying or another's is less relevant, but there is a mechanism in place to collect that data. At this point, we are unable really to know all that much about the loans that get modified.

Lastly, I do think it's important to balance the burden of collecting information with the value of that information. On the other hand, the Fed, the other financial regulatory agencies -- and I would include, for purposes of this discussion, HUD and the Department of Justice -- are at a tremendous disadvantage in terms of the information that's available with HMDA in terms of them looking affirmatively at what's going on in the market. The ability to include some of the more critical underwriting information would allow them to do a better and more conscionable job in terms of identifying where there are patterns with respect to discrimination and other areas over which they have purview. Thank you.

MR. GRIFFIN: I would just like to point out again, as we discussed yesterday. A lot of the data that we're discussing adding -- I was heartened to hear that somebody might consider omitting data yesterday, but I don't know if that'll actually happen. A lot of the data we're looking to add is available to the primary regulators of the banks. The banks are collecting and reporting to the regulators credit score, loan-to-value, debt-to-income, so that is getting looked at. It sort of sounds like in this discussion, sometimes, that no one is looking at that. The regulators certainly are aggressively looking at it when they come in to examine the banks.

MR. CAREY: Just a couple of quick points. I think Mike's point around fair lending exams is real. It's a role that I think the institutions and their examiners take seriously. MR. CALHOUN: John, can you speak in the mic?

MR. CAREY: Oh, I'm sorry. Thank you.

You've been through a fair lending exam -- it's real, it's challenging, it's difficult. Examiners take it seriously, and institutions do as well. I think the technology hurdles are significant -- different systems, different challenges that come with that. I don't think that can be diminished. There’s sort of a tension here. We talk about data integrity, which is always an issue with pulling this stuff together, and, again, institutions are subject to significant fines if they get it wrong. Then if you multiply that by adding additional fields, it again makes the thing very difficult for institutions to basically deal with. And that's, essentially, the balancing act. As we look at these things, let's focus hard on, ultimately, what is the purpose for this data and is there a way to do this efficiently and effectively without placing undue burden on one side of the industry over another. Those are my thoughts.

MS. ENGEL: Corey.

MR. STONE: I wanted to make a note about cost. There would be some value, I think, prior to the hearings in mapping out the data flows that happen as part of the mortgage origination process. As somebody who spent more of my life trying to interface with the origination systems than I'd care to admit, they are pretty ubiquitous. They're placed at every broker and every direct lender, and many of the data elements that are being discussed as additions to HMDA collection are captured by the systems. So, if we can map those data flows, we'll have an idea of what is easy to collect and low-cost to collect and what would really be burdensome.

MS. ENGEL: Mark, you had some thoughts about some of the actual questions that the staff had presented to us.

MR. WISEMAN: As the Board considers the different costs that are involved with increased data that the institutions have to come up with, certainly there are arguments both ways, but we just spent an hour yesterday talking about how 80 percent of the people in Kenya bank on their cell phones. So, to sit here and believe that it's going to be such an over-burdensome thing to start collecting certain data and to make it standardized throughout the industry, color me among the skeptics.

There are also other costs involved in not having the appropriate data. The costs of trying to figure out who the responsible parties are; the costs of trying to determine if a certain lender did or did not target neighborhoods of color and people of meager means for loans like this because the HMDA data itself doesn't collect anything; the cost of cleaning up the neighborhoods. Those are costs as well. It's not just a question of how much more are the banks going to be taxed to do all this, to take all this information.

In terms of nuts and bolts, there are many questions surrounding who the actual originators of loans are and finding them, and figuring out which ones actually had to report the HMDA data, and whether on the back end when you're looking at a certain loan, if it showed up in the HMDA data. If it didn't, why didn't it? Was it a warehouse loan? Was it a loan that was held in a special-purpose vehicle before it actually went to the lender? And so on. These issues are all things, certainly, that have to be fleshed out and determined.

Just from an anecdotal perspective, I have seen many cases where advocates have said, after looking at the loan application, you know, this is kind of strange. I've got an African-American borrower and it says that he or she is white on the application. What's going on? And nobody really can figure out what's going on. But in an era when you have lenders not asking important questions, such as do you get a pay check, I am certain that they didn't ask what color do you happen to be or what race do you happen to be? I think there's a gap between the initial data collectors and the people reviewing the data to determine whether or not that data is important, so I think that needs to be addressed as well.

Also, for my money, I think every loan that is secured by somebody's personal residence should be reported to HMDA, no matter who the originator is, no matter what's going on. Now, I realize that some of that issue certainly is beyond the hearings or what the Board can do, but that's certainly an important issue. If only 50 percent of the players in the country have to report HMDA data, the data itself is defective and cannot be used for what I think most people want to use it for on the back end. Thank you.

MS. ENGEL: Shanna, do you want to talk some about the issue of brokers? You had some ideas about preapprovals and things.

MS. SMITH: Many of the mortgage brokers are originating for two or three lenders. Having looked at hundreds and hundreds of broker applications that go to the lenders, something that I started to notice in this review, which was in cooperation with the lenders, is that oftentimes the lender made a counteroffer that was better than the original application. And, for some reason, the borrower didn't accept that counteroffer. We were digging a little deeper and found out that the counteroffer was never conveyed to the borrower. The broker instead ended up pushing a loan that could have had a lower interest rate, but higher fees that went to the broker, and it ended up costing the borrower more money.

Unlike a real estate sales transaction, if you make a counteroffer, the buyer has to sign it, if they accept or reject it, and in mortgage lending, the brokers control everything. So a couple of misperceptions happen. The lender, who denied the original application, has to report on HMDA that it was a denial, and they don't have an opportunity to report that they made a counteroffer, and the counteroffer was either accepted or rejected. So it often can skew what the denial rate of a lender can look like, because the brokers are controlling it.

The other thing we don't know, because we don't capture information through the brokers, is how many people are rejected right at the door by a broker, and that application that they've made never even gets to a lender to be captured in the HMDA data at all – if there's a way to start looking at capturing information from the brokers. One of the lenders we worked with did a lot of work with brokers and said they could not unilaterally demand that brokers start providing this information because the brokers would stop doing business with them, because other lenders didn't require it. If we have this as a requirement -- that all banks and other financial institutions that are having brokers originate their loans require some reporting for HMDA basis -- then the brokers will have to do it.

Now, we have the question of will they do it accurately? That's a whole other issue, but we're missing capturing some pretty important information because so many people, particularly people of color, are going through mortgage brokers to get their loans.

MR. CAMERON: Kathleen, at the risk of whining here, I felt I had to reply to Mark, who doesn't believe that the burden is onerous.

(Laughter.)

MR. CAMERON: There is an extreme burden on small institutions, both credit unions and banks that have very small staffs, who are required to complete the same data sets that large institutions are, and who simply don't have the capabilities in terms of equipment or people to do that. We are burdened really to a degree that is overwhelming by other regulatory requirements. The need for compliance in such a vast scope of areas is such that nearly half the time of people running small credit unions is devoted to compliance. And this is just one more compliance burden that has to be met. To simply expand it because we might gain something out of that data is not a sufficient reason to add that burden on those small institutions, or any institution, frankly. I would contest that there isn't a burden. I think there is. It's real, it's onerous, it's expensive, and it's one that isn't outweighed by the value of the data.

MS. ENGEL: Dory.

MS. RAND: I just want to respond to Alan. I admit that the requirements for data reporting can be burdensome, but I really disagree strongly that the value is outweighed by what we can gather from it. I think the evidence of disproportionate impact and discriminatory lending is so pervasive, and yet we don't have enough tools to get at those fair lending issues. It's going to be a problem for generations. The wealth that has been stripped from communities of color is going to have an impact for so long, it has wiped out so much of the wealth in our communities, that it needs to be addressed. I think it's important, even if it does cause some burden, to get that information so we can start closing that racial wealth gap.

MS. ENGEL: Saurabh, and then Kerry.

MR. NARAIN: I just want to continue commenting on the burden issue. We work with a lot of small banks, and I really want to go back to what Mike was saying about rationalizing. The idea of strengthening is not, necessarily, expand unnecessarily. We hope that we will get to a point where we will actually reduce some data points too.

MR. GRIFFIN: I'll buy you a drink when that happens.

MR. RHEIN: I'll buy you a house when that happens.

(Laughter.)

MR. NARAIN: Our mission has been to use this data and actually help those institutions do better, get more funding so that they can do work in low- and moderate-income areas. This information, this transparency from HMDA has really helped different kinds of stakeholders support low-income credit unions and low-income CDFI banks do their work better. So, I would be a strong supporter of that -- that we strengthen HMDA, we collect the right kind of data, and not necessarily only expand. It’s burdensome, but there's value associated with that.

MS. ENGEL: Kerry.

MR. DOI: Thank you, Saurabh, for those comments, because that's very similar to my line of thinking in that, when it comes to data collection, yes, there's a whole lot of effort that has to get put into reporting of any kind. In the organization that I represent, we have 30-some contracts with various government agencies, so let me tell you, we understand the burden of reporting and paperwork. The way things get reported oftentimes can be subjective, where a person may be black and check off the box that says white. My adopted black daughter often checks off surveys being Asian because she was raised with a Japanese-Hawaiian culture, so she says what's important is what you are inside, not necessarily what you are outside. So, data can be skewed. I'm sure that my daughter is more the exception than the rule, but yet it's important.

I would guess, and with all respect to my banking colleagues on the Council, the better you understand your market, the more money you're going to make. In the small business entrepreneurial training that we do in our organization, that's what we train them to do, is to understand your market. The more data you have, the more you understand your market. I think it's a good business decision to collect that data and see it as a cost of doing business.

MS. ENGEL: Phyllis.

MS. SALOWE-KAYE: With such limited resources to non-profits who are counseling folks, it's really important to have the data so we can identify where problems exist in terms of foreclosure and where we have to direct our resources to prevent or to assist and, for first-time buyers, to be able to know where lending is not taking place and to be able to direct marketing campaigns to the right people so that affordable products will go to the people that need them. Having that information, and the additional information, at a time when resources are so scarce becomes really important.

MS. ENGEL: Ira.

MR. GOLDSTEIN: I'd like to just add another voice to the burden question, and that is that HMDA, over the course of time from its inception, recognized that it was very difficult for small institutions to comply with the data collection and put thresholds both for depositories and non-depositories about how much there needed to be before they were even required to report. Those thresholds have changed many times since HMDA has passed. Part of the balancing historically has been recognizing that these really small institutions don't have the wherewithal to do it. Certainly, as part of the balancing going forward, you could look at changing those thresholds again. Over the course of time, certainly, the number of institutions reporting to HMDA has dropped off dramatically -- consistent, I think, with those threshold changes.

But in any event, part of the balancing at this point could be, again, looking those thresholds. I didn't want it to just sit out there as if every institution, if they make five loans a year, were still required to comply with that burden of the data collection.

MS. ENGEL: Kevin.

MR. RHEIN: I guess, first off, the number of institutions that aren't reporting, a lot of it is because they don't exist anymore, so it's not a question of the bar has been raised, but that they're just gone. An incredible number of mortgage origination companies don't exist anymore. You can go right down the list of Countrywide, Washington Mutual, et cetera. But what I think is important to try to understand is there are preventative controls and there are detective controls. HMDA would be a detective control. It's a reporting after-the-fact of essentially what went on, and there is value in that type of information.

But what's far more valuable is preventative controls. If you step back and look at what's happening around financial reform, there are changes that Fannie and Freddie are putting around documentation, so the liar loans, the no doc, all that kind of stuff, is going away. There are changes in originator compensation that are being considered in terms of whether they can charge overages. There are changes in the way securitizations are being done, that originators are going to have skin in the game. There are so many things that have been layered into this process, that are getting at perhaps the fundamental behaviors that caused the problem to begin with. All I would encourage people to do is try to let some of the changes play out and focus far more on preventative controls, as opposed to detective controls.

There's a very good process -- banks go through an excruciating fair lending exam, and the information does exist in the banks, and the examiners have access to that. There is no way HMDA reporting would ever give you all of the information to understand all of the different risk factors that go into a credit decision, but the examiners do have that information, and they do put us through a very extensive fair lending exam. I'm just quite perplexed -- more and more data, for what purpose?

MR. NAVARRETE: I wanted to build on Kevin's point because I think it's an excellent one. I come from a company that loves data, and so it's certainly something that we instinctually understand the value of. But data for what purpose, I think, is a pretty critical question, and then the resource issue of where you want your compliance and other folks vectored.

Building off of the point of preventative controls, you also want those resources allocated to internal monitoring and enforcement, rather than data collection exercises that are more externally facing. The patterns and practices of discrimination within institutions are rarely isolated and they're rarely narrow, so the notion of using data to pinpoint the source of it, rather than having broader programs that are designed to sort of tackle policies and actual practices in the front lines, I would say that more energy should be put towards the latter, again, both internally with respect to the resources that we have vectored against this, but also externally in terms of examination staffs of the regulators also ought to be focusing more of their energy on enforcement rather than data mining that will probably just double down on the amount of evidence that exists that certain practices are taking place.

MS. ENGEL: I'm just going to make a quick response. I think it's really great that Andy wants more money and effort to go to enforcement. I just have a couple of quick thoughts. One is, I wanted to follow up on Corey's comment about systems that already exist for collecting information. It's really easy for me to think big because I don't have to do the jobs that the staff has to do in terms of making all this HMDA reform work. But it seems that it could be valuable to survey institutions to find out what data they're collecting internally, what systems they use, what data they're collecting internally for submission to places like Loan Performance or McDash, industry collectors of data, what's getting collected for government purposes, whether it's for examinations or HMDA or maybe even state reporting requirements, and to really see what are all those different systems and what could be done in terms of HMDA reform that could potentially integrate these different systems, or the information in these systems, and ease the burden that way.

A second thing is, I think that the IDs are really important. One of the problems for brokers, lenders, and the like, one of the problems with the HMDA data, even when you use institution-level data, the IDs, for example, for brokers -- it may be one time I'm K. Engel, the next time I'm Kathleen

Engel, and then I'm Engel with my name spelled wrong. It's really hard if you're doing any kind of analysis with that data. I think that brokers now have unique identifiers, but we need to do the same thing with lenders, with arrangers, with trusts for the purpose of tracking where the loans are going and ending up, who the servicers are. That could really help on an individual loan basis, it can help with analysis by institution, and it also could be helpful in looking at broader policies.

The third point I wanted to make is that I don't see HMDA's goal as being solely about institutions. The fair lending exams are really the place where the institution-level research or enforcement is being done. HMDA has, I think, a broader purpose, which is to really look at trends that are happening in the country to be able to inform policy, to identify problems and things like that. If we think of HMDA that way, then the fair lending exams aren't a substitute, and that's one of the reasons why we need it. Kirsten.

MS. KEEFE: I certainly agree that there should be more preventative controls, and I am all for that, but I do believe that the detective controls that you talked about, Kevin, it is a very important purpose of HMDA. I just want to cite three examples in hindsight.

I can't tell you how many times in the last 12 years I've been asked, do you have any loans that have credit insurance or yields for premiums? As a consumer lawyer representing individuals, I have constantly been asked -- and I'm sure Mark has as well as others who are doing direct services -- for examples of real-life situations to the end of trying to prohibit some practice or get some policy to get rid of some bad predatory practice.

In the late ‘90s, it was credit insurance, credit life and credit disability insurance, which is now pretty well known and accepted that that was a pretty egregious predatory practice of financing credit life and credit disability up-front in the loan. Now it's actually considered a finance charge if you do that, unless there's really explicit, voluntary choice on the part of the consumer to get that. But we fought for years trying to talk about this abusive practice, and we had to come up with our own individual examples. If we had had that sort of data reporting, we would know -- and not we, but the policymakers -- would have known how many subprime loans had these products in them, and they would have known the amounts. So, that's one example.

Another example that I can think of is from almost day one of the subprime predatory lending back in the `90s, advocates identified that most of these loans were broker-driven loans. I often thought if you just got rid of broker-driven loans in the subprime market, everything would be fine. Now, again, we promoted the idea of greater regulation on brokers and greater compliance for brokers or greater oversight by the lending industry of the brokers that they were using, but it was through individual cases. If we had had information about the loan originator at that time, we would have known and it wouldn't have taken until 2007-2008 for the light to dawn, and for us to think oh, well, maybe we should be imposing more duties on brokers or more oversight by the lending industry.

The third example in hindsight is yield spread premiums. Again, this was another sort of example consumer advocates and lawyers were constantly being asked, can you give examples of your borrowers paying a yield spread premium as well as an up-front broker fee, to really show the abusiveness of some of these products and the amounts of the yield spread premiums. If we had had that loan-level data, it would not have taken until really just now for the light to be shined on how abusive the yield spread premium was, particularly in the subprime mortgage lending product.

I really think that detective role or function of HMDA that you mentioned is a critical piece of it. I will never be able to think ahead to the practices and loan products and aspects of loans that the lenders will come up with, and that's fine. We will never be able to prospectively regulate against everything, and so I do believe that that detective aspect of the HMDA data is extremely critical.

MS. ENGEL: Dory.

MS. RAND: I just want to agree with Kirsten. I think that, Kevin, you raise a false dichotomy. It's not either preventative or detective.

MR. RHEIN: I didn't say it was.

MS. RAND: It works together, as Kirsten said, so that's all.

MS. ENGEL: Ira.

MR. GOLDSTEIN: When Congress wrote the Fair Housing Act, they rested in HUD the authority, and I think I would say responsibility, to do Secretary-initiated investigations, whereby outside of the fact that somebody comes into HUD and says we have a problem, they're responsible for looking at the marketplace and identifying patterns and practices that may be reflective of discrimination. At this point, the way the HMDA data is released and the amount of information that's in the HMDA database, HUD, and then its partner in these things, the Department of Justice, and, again, the other financial regulators, they're at a unique disadvantage with respect to their ability to do that stuff.

As a matter of fact, by the time HUD and the financial regulators actually get the HMDA data, the statute of limitations for these things has almost expired. Their ability really to execute their responsibilities under the congressional mandate under the Fair Housing Act is uniquely hampered by the sequencing, the release of that HMDA data, and the amount of information that's in it.

MR. RHEIN: To exactly that point, and, Mike, you're probably a little more familiar, but go back and think about what you've asked for. You want origination data, you want servicing data, you want loan modification data, you want it on home equity loans, you want it on reverse mortgages, you want it on all different types of first mortgages, et cetera. Think about the number of reports, and to John's point earlier on penalties for accuracy in the information and stuff like that. So you've created this unbelievable amount of data that you want, and now you're going to want it faster, more accurate, and everything else. It just simply isn't realistic to expect faster, more, across all these different types of portfolios and all these different types of actions -- and, again, for what potential benefit?

When you've got regulatory bodies that can come in and get this data and look specifically, you're basically providing this information out to a lot of other public sources, and what are they really going to do with it? Saurabh has said they're going to try to direct money into a different area. The vast majority of what happens with this data is, we get brutalized in the press. You get criticized for everything that you do. In many cases, the information that's there -- it goes back to the fact that you will never be able to understand all the risk-based information that goes into a loan decision. You just can't make all that information available, but it is available from a fair lending perspective.

MR. NAVARRETE: Dory, just a quick response to your point. I agree, it's not a dichotomy, but from a practical perspective there are limited resources available to work on these issues, again, both in government and in the private sector. All kidding aside on asking for more money for enforcement, the fact is there is no more money out there either at institutions or in the government to take care of this, so it's an allocation of the existing resources that we have. The question is, or the choice is, do you want more people devoted to data mining, or more people devoted to transaction testing, for example, or monitoring on the front lines? That's the choice I think that we are trying to articulate here.

MS. ENGEL: Mike.

MR. CALHOUN: I have three quick comments. One, I would agree with Kevin --

MR. RHEIN: Oh, it's the big one.

(Laughter.)

MR. CALHOUN: -- on one part, that we have been going through an annual dance for the last couple of decades when the HMDA data is released. It shows very stark gross disparities in lending practices, and industry says, pay no attention to these numbers because they don't have enough data to show whether there is causation rather than just correlation. Now this is sort of the rubber meets the road. Well, do we want the data to show the correlation?

You're looking at over half of African-Americans in subprime loans with the greatest disparity between minority households, in black households with incomes over $100,000. We're putting out a study this week -- one out of six Hispanic homeowners with a mortgage will lose their home in this crisis, one out of six. There are pretty stunning, gross numbers out there. We do agree, and some of our reports have found, that where there are gross disparities, often there are differences, but sometimes they're not. And that's, I think, what we're trying to get at, but it would be nice to break this cycle that we've been into. We've almost all got our scripts down each year for when the HMDA numbers come out.

The second I would say is, in response to another item, that we tend to have the best of the practitioners and the best of the companies represented at this table. Unfortunately, you can't write the regulations for the best performers. We investigated and looked closely into practices of other folks, and, quite frankly, they weren't operating in good faith. They weren't, instead of putting the resources into data collection, putting it into preventative and protective measures. In fact, they were putting it into destructive measures. It's an unfairness in the system that, quite frankly, the companies here bear the burden of some of the practices that were allowed to flourish. And that's why we do agree with you that the way to have impact is bright-line rules that everyone can operate under, and we would commend some of the rules that the Fed has under consideration, such as the yield spread premium rule, which has been one of the worst practices that we've seen out there. But also, again, we need to test which of these work, so I would urge that to be one of the goals of HMDA.

Then, finally, I thought, Corey, some of your comments -- there is incredible sophistication in data collection out there, and it's been out there for a while. We get solicitations from companies who say we will sell you by the name, here are the people in your geographic area who have home equity and are having credit problems, and here's a lot of data about them. And you get them for cents on the name that they'll provide you. Here's effectively a target list to go after to solicit troubled borrowers for refinance loans. The industry has found a way to collect that data and collect it very efficiently.

I do believe in the burden of data collection. I do believe that it's a real cost. I believe those costs are not eaten by the companies; they are passed on to customers. They're not free. But the place to look is how do you match up and coordinate with existing data systems that are out there. Underwriting, even more so now than maybe in previous years, is quite automated, and we ought to be piggybacking on those systems to get us the data. As much as I enjoy the dance, it would be nice to have a different tune next time the data comes out.

MS. ENGEL: Okay. I think we need to wrap up and move on to small business. One, really two comments. One is, the other dance we do is anecdotes versus data. We could get rid of the anecdotes and just have data, which would make everybody happy.

(Laughter.)

MS. ENGEL: But the more important point is that, as you know, the Fed staff really relies on the input of the public, of CAC members, and people from different organizations in thinking about things like HMDA reform. I just want to encourage everybody to look at the questions that the Fed staff provided to us for these meetings and to be responsive and help to make this a process that works for everyone.

MR. CALHOUN: Thank you for leading that discussion, Kathleen, and a perfect segue to our next topic, which rumor is that the Governors have heard a little bit about, and that's small business access to credit, and whether that has been constrained or whether demand has been reduced. I think it's another place where data and anecdotes perhaps move in different directions.

Gross data shows that there has, in fact, been a decline in small business loans outstanding, a significant one. Given the concerns about the challenges for the economic recovery and the condition of small businesses, this issue has gotten a lot of press. We discussed it yesterday, and Andy Navarrete will lead our discussion today about that issue.

MR. NAVARRETE: Thanks, Mike. Having spent the better part of the last few decades trying to work with Congress on a number of issues, I can tell you we've tried it with data. The anecdotes always seem to overwhelm whatever it is we produce, no matter how grounded it might be.

(Laughter.)

MR. NAVARRETE: I tend to believe that anecdotes are here to stay as a major policy driver.

It is, actually, a perfect segue. It's interesting, as a committee, we've often debated whether or not we actually have jurisdiction over small business issues. There's certainly a lot of passion on this topic among many of us. Having devoted two sessions yesterday to the topic, I guess we've tacitly concluded that we do. But we want to first thank the staff for providing a summary of the terrific report, chock full of data, that they provided on small business use of credit cards. I think there were a number of folks who were surprised by the dynamics of the small business credit card market -- the very heavy emphasis on transactors, folks who in small businesses utilize fairly high-line products for really cash-flow reasons rather than borrowing, and that the percentage of borrowers in the small business market is actually quite modest, in comparison, and has actually remained static over the course of the recession.

I think that does very much fly in the face of anecdotal stories, particularly for many of us who travel around the country and hear from small business owners who are struggling to get credit. The meshing of those two and the reconciling of those anecdotal elements and the data elements will continue to be a challenge. But the report, I think, is a very effective snapshot, a very consistent set of views with our own experience as a small business lender, both in the card space and traditional branch-based space.

The other issue that came out of that was a question of whether or not Reg Z ought to be applied, all or in part, to small business credit cards, in addition to consumer cards. The staff report recommended areas of consideration but did not conclude definitively that it ought to be applied. We did note, as part of the conversation, that a number of institutions have voluntarily adopted all or a large portion of the Reg Z requirements for a variety of reasons, some of which is customer experience-driven and compliance-driven, some for operational practicality reasons, but certainly a worthy discussion, and one where we suspect there will continue to be dialogue about what the right answer is. But given the differences and dynamics of the small business credit card market, moving a bit more incrementally and not just adopting those provisions wholesale seemed like the prudent course of action in the near term.

The second session, and I'll turn it over to a number of folks for comments in this space, dealt with more traditional small business credit issues, more of the commercial lending side of the equation rather than the card side of the equation, and some very interesting dynamics that have come out of there.

In the same way that the anecdote-versus-data debate is part and parcel of the credit card discussion, the demand-versus-supply debate is part and parcel of the discussion around access to small business credit. In our own experience, we pointed out that our approval rates for small business loans in our branches has actually remained constant and, in fact, increased recently with respect to the number of approvals of applicants coming in, but the application volume has dropped precipitously. So, we tend to believe that this is very much a demand-driven issue.

Again, it is a tighter set of controls and a tighter set of underwriting standards in a recessionary environment, but demand has fallen considerably, which is logical given, obviously, the decline in consumer spending driven by a variety of factors and also, ultimately, the lack of sales or lack of confidence among small businesses to be expanding at this particular point in time.

We talked about a number of different programs, a number of different initiatives underway that can help address this issue and perhaps close this gap. I'll start off with recognizing Saurabh, who had some very interesting observations in this area and will also be speaking on behalf of Ron Phillips, who couldn't be here today, but is one of the more passionate voices on small business issues within the committee.

MR. NARAIN: Thank you, Andy.

Ron and I are both part of the New Markets Tax Credit Coalition, as well as represent the CDFI industry working in the toughest markets in the country. Ron, particularly, is very concerned about two issues. One is the issue about small businesses in rural areas. While there's a lot of emphasis on flow of capital into small businesses in urban areas because they're much more visible to a lot of us, rural areas are sometimes left out. One of the proposals there is to actually try to put some sort of an ad hoc number on routing of capital into small businesses, as it relates to small business in rural areas.

The second issue relates to a very significant program of the Department of Treasury called the New Markets Tax Credit program, which has worked brilliantly for different kinds of commercial real estate businesses, but has not worked in the small business arena for a number of technical reasons, particularly relating to the fact that there is reinvestment risk associated with that. I won't go into the details of that.

One of the key provisions that we as industry are promoting and advocating for is some kind of a safe harbor associated with investing in small businesses using the New Markets Tax Credit program, such that more and more cash can actually go to the grass-roots to help the local communities. Ron and I both strongly support small businesses and the New Markets Tax Credit program to bring in capital to that sector.

MR. NAVARRETE: Thank you, Saurabh. Mary.

MS. TINGERTHAL: I'd like to talk particularly about the materials that were shared with us yesterday by the staff around the SBA programs. First of all, I was really pleased to hear the staff report that, partly as a result of the Board's focus on small business, there's been really an increased dialogue with staff at the SBA. One of the reasons I think that's so important is because the SBA programs sometimes are kind of small in the context of the greater economic trends, but I think they really serve as an important lubricant for bringing capital into the small business market with the 7(a) guarantee program as well as the 504 program. I'm just really glad to hear that the staff is in a greater dialogue there.

I wanted to talk particularly about some of the recommendations that are in the Administration's proposed initiatives around SBA, around the 504 program. I've had the experience in a previous life of working with the SBA 504 program pretty extensively. For those who don't know how it works, the SBA actually issues SBA debentures that are backed by second mortgage loans that are made to businesses, and those loans are secured by a second mortgage on their business real estate. In front of that second mortgage is a first mortgage that is originated by a commercial bank or a community bank, a bank that holds a first mortgage that has a loan-to-value ratio typically of something like 50 percent. They've been considered for a very long time to be a very safe loan for the bank to make.

One of my concerns about the 504 program right now in the environment we find ourselves is that, prior to the economic crash, there had begun to develop a pretty robust secondary market for those 504 first loans, so that the type of loans that could be extended to small businesses were actually fixed-rate loans with terms in the range of 20-25 years. My fear is that in the current market, with no secondary market because of the inability to securitize those loans, that those loans have now fallen back into probably a five-year balloon, where those businesses are going to experience an interest rate increase for those loans when that time comes for the balloon.

I'd just encourage the staff to maybe talk with their SBA colleagues about whether there's an issue there and whether there could be a bit of a lubricating effort to make sure that that secondary market for those very safe small business loans secured by small business real estate continues to exist in this market environment.

MR. NAVARRETE: Thank you, Mary. Corey.

MR. STONE: Yes. I just wanted to share some recent market research that we did in our northeastern small city looking for target business segments where our bank will be lending. One of the striking things that we found, besides the fact that it's a competitive market, takes a long time to cultivate a customer, is the fact that many mature small businesses have gotten quite sophisticated in being able to use a range of financial services providers, and many of those providers are national, specialized lenders who cherry-pick pieces of the business. Specialized equipment financers, people who provide business cards fall in that category, vehicle leasers. It leaves a smaller share of wallet for us to pick up when we pick up a customer. Essentially what that does is it raises the threshold of the size of business we can serve, and it also limits the amount of what CDFIs call technical assistance, which as a banker I would call servicing and marketing and cultivation that we can provide up-front when we're cultivating a relationship. The implication of that is, for the smaller businesses, we're going to rely very heavily on our state’s and city’s small business technical assistance centers to help small businesses prepare for a borrowing relationship with us. That's an extremely important part of the lubricant in our market, and I assume in other markets as well.

MR. NAVARRETE: Thank you, Corey. Shifting gears a little bit, we also talked about the fact that there are often blurred lines between personal credit and small business credit, particularly for micro-businesses, and Jennifer wanted to talk a little bit about that.

MS. TESCHER: Thanks. To Andy's comments earlier about whether or not this body should be focused on small business, I think that for a decent percentage of the smallest businesses, the line between business and personal is very blurry. They're one and the same. I think that's even more true in today's environment where someone loses a job and, rather than trying to find a non-existent job, they say, okay, I'll start my own business. It's a very common thing going on right now. I do think that there's a data question about how much of this problem at the very, very micro level has to do with folks having tarnished personal credit, as opposed to other risk factors that are used in the underwriting practices. Pretty much all kinds of small business lending at the small end is going to involve a personal guarantee of some kind, and so I think that we just have to keep in mind that as many Americans are going to face challenges with their credit, this is going to have repercussions in the micro-business market.

I think it behooves us to really start to look at enhanced data types that we can use to better underwrite people, particularly in terms of their personal credit history. I think a lot of us have lost faith in many of the common traditional credit bureau practices and products, and I think that it's time to start looking at an expanded array of data to better underwrite consumers.

MR. NAVARRETE: Thanks. John, you had a comment, as well.

MR. CAREY: I think Corey covered most of it, but a lot of these larger institutions --

MR. RHEIN: John, use the microphone.

MR. CAREY: Kevin, this is the second time you've reminded me.

(Laughter.)

MR. CALHOUN: Kevin, you're not saying that when the consumer advocates are speaking.

(Laughter.)

MR. CAREY: A lot of this stuff, particularly in small business lending for larger institutions, is largely about scale. A lot of lending that goes on in small businesses is highly specialized. When you run large shops, you've got to have a certain amount of scale. The larger institutions tend to move towards those that can give you the kind of scale that you need to have to drive the efficiency because the effort that it takes to go out and underwrite and make small business loans can be terribly time-consuming and may not be something that large institutions can do efficiently. It's a gap that's there. We at Citi have devoted a lot of time to it, but the recognition that there is also a lot of specialty lending out there -- equipment financing and things like that for doctors or dentists. We can't compete in that space because we can't get the price points and have the kind of efficiency that those that cover that can do, so there are gaps. We spent some time talking about that yesterday, so I thought I'd call that out.

MR. NAVARRETE: Thanks, John. I think we have time for just a couple of more comments, so I'm going to go with Kathleen, and then Betsy, and Saurabh.

MS. ENGEL: I just want to go back to our discussion about small business credit cards. One of the things that concerned some of us was the conclusion in the report that went to Congress. In particular, in the report, one of the conclusions is that restricting the ability of card issuers to adjust interest rates may lead to higher initial interest rates, which would harm firms that borrow on small business credit cards. The report is kind of neutral -- it doesn't say there should be more protections, nor does it say there shouldn't be. I want to argue for a minute for why there should be more protections in this space.

The first is that we have an experiment. As Andy mentioned, there's several small business credit card issuers who have decided to extend the Card Act provisions to their small business credit cards. If, in fact, it is going to lead to higher interest rates, those firms should be experiencing a loss of customers, and people making a choice to switch their business credit cards to firms that are not adopting the Card Act provisions to that product. I think that's worth looking at -- what's the experience of those firms. If, in fact, they aren't losing business, that suggests that it's not a bad idea to extend the Card Act to those types of products as well.

The second point really goes to what Jennifer was saying, that it's pretty clear that in most cases, the underwriting on the small business credit cards is really personal underwriting, because the individuals, owners of the businesses, have to submit their own credit information because they're the guarantors on the card. If that's the case, there really isn't much of a difference between a small business credit card and a personal credit card, and I would say that argues for protections to extend to those products as well.

Lastly, one of the key things that we learned from the mortgage crisis is that the most vulnerable people are the ones who receive the marketing information, who get pushed for these high-cost products. It goes to what Mike was saying about how they're trying to sell him lists of people to go after, or some marketers are. The same thing is true when you look at the small business credit card information in these reports. These are the people who are paying very high interest rates, and they're carrying a balance forward. They're not using their credit cards just for cash flow; they're using them for loans. Those are the people who are most in need of protection. By extending the Card Act to the small business credit cards, we can protect those most vulnerable people, presumably, based on what we know so far, without imposing unnecessary costs on the people who use their credit cards simply as a way to manage cash flow.

MR. CALHOUN: We can get one more brief comment, and then try and keep on schedule.

MR. NAVARRETE: Sure. Betsy.

MS. FLYNN: I will just speak for the 5,000 community banks across our nation that take great pride in meeting the credit needs of our communities and particularly the small businesses because those are the businesses in rural areas that create the most jobs in our community that enhances the economy. I know our loan portfolio in 2009 grew 12 percent. It has grown 20 percent since January 1 because we are meeting the needs of our community.

MR. NAVARRETE: Thank you, Betsy. Mike, back to you.

MR. CALHOUN: Thank you. One of the next topics that we took up was the Community Reinvestment Act, which I think is important, not only the significance of the issue, but also it demonstrates that, while often we hear the differences highlighted in our views in these sessions, there was a lot of consensus on the need to revisit that Act, both legislatively and for the regulations.

First, I'd like to recognize Sandy for some comments about developments there.

MS. BRAUNSTEIN: Thanks, Mike. I think this is a record that I get to talk twice during one meeting. This is really exciting.

(Laughter.)

MS. BRAUNSTEIN: This morning I'm really pleased to announce that we are -- this is kind of breaking news for us, because this is happening as we're sitting here in this meeting -- but we are going to be issuing two press releases this morning. If they're not already out, they will be out imminently. We are doing this on an interagency basis with the other federal regulatory agencies, the FDIC, the OCC, and the OTS. And both of these press releases relate to CRA.

The first one, we are issuing a proposed rule change to CRA, which we're putting out for comment, that basically encourages depository institutions to support HUD's Neighborhood Stabilization Program, the NSP program. This proposal will revise the definition of community development under CRA to include loans, investments, and services that support NSP-eligible activities.

This revision will allow financial institutions to receive favorable consideration under CRA for these NSP-eligible activities. These activities would benefit, obviously, low- and moderate-income people but also, in many cases, middle-income individuals in geographies that are in designated target areas that have been identified and approved by HUD. So, that's one piece of it.

The second piece that we're also announcing at the same time is that we are going to be looking more broadly at CRA and regulatory changes that are needed, due to the fact that it's been a long time. Certainly, markets have evolved and developed, and it's time for us to look at CRA in a broader context. In order to launch that look at CRA, we are having four public hearings on CRA. We're going to be very busy this summer with public hearings.

We are going to have hearings on July 19 over in Arlington, Virginia, at the Seidman Center, the FDIC's building in Arlington. On August 6, we will be in Atlanta, Georgia, at the Atlanta Federal Reserve Bank. On August 12, we'll be in Chicago at the Federal Reserve Bank in Chicago. And on August 17, we'll be in Los Angeles, California, at the branch of the San Francisco Fed.

So, we are looking forward. We talked to the Council yesterday about a list of areas that we're looking for input on for CRA, and we are looking forward to hearing people's input, both today in discussion as well as moving forward. Hopefully, many of you will be able to attend one or more of these public hearings and provide input through that process also.

MR. CALHOUN: Thank you, Sandy, and thank you to the Board for your leadership on this issue. Saurabh is going to lead our discussion of this today.

MR. NARAIN: Thank you, Mike. I want to start by thanking Sandy, Chairman Bernanke, the Fed, and the agencies for taking this leadership role in not only using the CRA for this emergency situation that we have today, this financial crisis, the crisis in the economy, but also in thinking about modernization and strengthening of the CRA.

The Community Reinvestment Act has been, in my mind, one of the most effective acts that has resulted in a significant flow of capital in low- and moderate-income communities. It was set up in the 1970s, and the markets have evolved just a tiny bit since then. Financial institutions have evolved, communities have changed. The way financial services are being delivered has changed a lot.

Today, particularly with the significant distress in low- and moderate-income communities, both urban and rural, this is extremely important for us to think about making sure that we modernize and strengthen the CRA.

As we think about some of the issues relating to CRA, we think about two or three aspects. One is increasing geographic coverage and assessment areas, and how do we think about assessment areas given technology and given the way financial services are delivered today. Expanding the CRA to either affiliates of banks, other lenders, and other financial service providers or products. And, three, thinking about community development and emergency issues. With the leadership of Mike and the Federal Reserve Board, the CAC has created a small subgroup to look at CRA issues, and Ira Goldstein has been leading that. I want to recognize Ira and ask him to talk a little bit about the subgroup and what it's thinking of achieving, how, and so on.

MR. GOLDSTEIN: Thank you. Yes, we have this working group set up. We actually started it under the previous year's CAC activities, and the majority of the people who were on the group at that point rolled off as their term expired. As an expression, I think, of the amount of interest there was on the CAC in this topic, when we reopened it to people to get involved in this, I think virtually everybody on the CAC expressed their interest, so that was quite remarkable.

We are going to take up a variety of issues, really right on point with what the Fed is interested in understanding with respect to CRA, being cognizant of the fact that near 30 years has expired since the passage of CRA initially -- over 30 years, actually. The aspects of geography and coverage will be quite critical in terms of the things that we look at.

We haven't yet had an opportunity to discuss in great length, obviously, the Fed's latest objective of taking CRA and being supportive of neighborhood stabilization activities. But, waiting to see what the final rule looks like, fundamentally, it makes great sense. You have a program that Congress created first in 2008 and then re-upped in 2009, and may be doing something with again this year. It has been something short of a remarkable success. So the idea of using this tool of CRA to be able to jump-start that and to bring more capital to the market or more cooperation to the market in the very same places that institutions have engaged in CRA activity makes all good sense. I think that the Fed and the other financial regulators really should be applauded for taking a look at that and taking that forward step.

Our work will transpire over the summer months, and we hope to be able to come back in October with some recommendations, not yet final, concluding our work really towards the end of the calendar year. But, again, all of the issues that were posed to the CAC yesterday for discussion around CRA are things that we will put ourselves into little sub-working groups, take them up, and sort of dig into what the history and economics and the like of each of these issues are and come up with some set of recommendations.

MR. NARAIN: Thank you, Ira. So, thinking of CRA, mostly it starts with consumer advocates, but this time I'm going to start with one of the bankers. Mike Griffin, if you can talk a little bit about assessment area changes, geographic coverage, as well as other forms of expansion that you're thinking about.

MR. GRIFFIN: Sure. I guess I would start with the way we approach this in looking at other lenders is very similar to how we approach CFPA -- that if the goal is to have a level playing field, then all players ought to be covered. To follow up on something Dory said yesterday, we really believe that the coverage for CRA ought to be based on the type of products people are offering. Whether it is an organization that's currently not covered by CRA or it's an affiliate of a bank that is not considered under CRA, if they're providing products that are considered under CRA, that they ought to be pulled into regulation by the Act. So that's our approach to that.

As far as the assessment areas, I'm sure I'll get a lot of boos and hisses from different places on assessment areas. I guess I'll look at my own institution. We have very much, certainly in the last couple of years, retrenched, stick to our knitting kind of thing, that where we're doing lending is where we have branches, so any expansion beyond where we have branches wouldn't have much effect.

As the one who evaluates our CRA performance, I can tell you where we have branches, where we have the highest level of service, where we have the highest level of lending in low- to moderate-income areas, where we have the highest small business lending. So, for me, the connection to the local branch is very obvious and very apparent, so I think that is an important concept to keep in mind.

I know there are banks that have one branch, so how do you approach those? I don't know that I have a silver bullet for that. I guess what I would propose is that they at least are able to get CRA credit for things beyond where that one branch is located. I think parts of Delaware are particularly overly advantaged because they have all of these banks headquartered there, and those banks have to focus on that one assessment area. That seems like an odd result from having those branches there, so certainly we'd look at that.

The piece that recently has been the most disconcerting for is how banks' investments in national funds, particularly national Low Income Housing Tax Credit funds, are being viewed. What's happened is, effectively, banks now, if they go into a national fund with other banks, they have to identify the projects they're going to take credit for for CRA. They've got to tag themselves to those.

Everybody makes sure that they're not double-counted. Because of that, that's been driven by the regulators, the funds are now only making investments where they have a bank that has an assessment area. So those rural areas, those small markets where investment is very much needed are getting left out of that pool.

The sort of strange impact of what I think was an attempt to make sure people didn't double-count the investments has been disinvestment in areas that need it the most. We've got to come back and find an approach that national funds make sense, so that we can cover the entire country and not just those areas that have a bank there with an assessment-area need.

And if I can just add, I know I'm going beyond your two questions, but because there were three questions from the Fed yesterday. The other piece, I think, that currently gets short shrift is all the things that people think about as community development. People think about the loans banks make to develop affordable housing and rental housing, those construction loans for Low Income Housing Tax Credit projects. Those loans are additive to the lending test, so the regulators look at small business, they look at HMDA. Community development loans are just an additive to it. We've always described it sort of as the topping on top of the sundae for our institution. It's not the main driver of the test. I want to make sure that that gets more credit as we move forward.

The other piece that really gets left out, because more and more continues to get pushed into this bucket, is community development services. Services are only 25 percent of the grade for a CRA exam. The generally accepted number is 80 percent of that service grade is based on where your branches are placed. Are you in parity with the low- to moderate-income communities in your assessment area?

That leaves 20 percent of 25 percent. So if my math is right, that's 5 percent of the whole grade for a CRA exam is about community development services. And we continue to say modifications, they're going to get credit. Well, that's in the service test, so that's in that 5 percent bucket. We develop significant products for the unbanked to provide services to people who don't have bank accounts. Again, that gets squeezed into this 5 percent bucket. Those services need to get more credit. Those take a lot of resources, a lot of time, a lot of commitment. If we don't give those somehow more credit in the exam, we're going to find that more and more banks are doing less and less of that work.

MR. NARAIN: Thank you, Mike.

MS. BRYANT-ELLIS: I just wanted to piggyback, because Mike brings up some great points. One thing on the national funds, as we are seeing those dry up. We are a regional bank, and we were participating in national funds. But because of the challenges that Mike spoke to, we've had to move to proprietary funds. So our proprietary dollars are only going where we have branches, whereas in the past we could have stepped outside of that.

And then the other part of that, the national funds drying up really excludes all of your small banks. Those 5,000 banks that Betsy spoke to, they can't get credit for a partial project. They might only have $1 million to invest in that national fund, and maybe an affordable housing project in a rural community, 30 units, might be $5 million. There's no way for them on their exam to get partial credit, so you don't see those dollars going into the national funds as well. So, national funds have truly dried up, and you have your larger regional banks as well as your national banks just doing proprietary funds, so you see them only where they have a branch presence.

The other thing that I thought was extremely important that Mike brought up is the community development loans. My organization does an extremely high amount of community development loans. But from an exam perspective, we call it extra credit. It doesn't get the same weight as your HMDA performance and your small business performance, where we are not as strong.

But we definitely make up our commitment to the community with our CD loans, and they do not get the same weight. And it is a lot of work to do those loans. Those are definitely your larger loans, over $1 million. But we don't get credit for those in the same way, so I think that's something extremely important to consider.

Then the third thing that is a great point that you brought up is that 5 percent that you're talking about. All of those other things that a lot of our action partners around the table want us to do, but it's only 5 percent of the overall exam. And it takes an enormous amount of tracking, resources, time to do those types of programs, but it's 5 percent of the overall test. If they are as important as I hear they are from the action groups around the table, then I think there definitely has to be a way to give consideration and more weight to those service programs within the CRA exam.

MR. NARAIN: Thank you, Paula. Kirsten, would you talk some about rural issues relating to CRA and how difficult or easy it is to get funding in those areas, both in New York state as well as generally?

MS. KEEFE: Sure. In the seven years since I have moved back to upstate New York, I think when I started there were about four CRA officers from banks who we knew and saw directly in the community groups that I work with, the housing groups had a direct relationship with, and now we're down to two -- and none from the major national banks, apart from Key Bank. But we really are left with two. Most recently, one of the major national banks not at this table let their CRA officer, who was most directly responsive to our area, go. Now, that's not to say there isn't CRA representation, but you'll have one officer for sort of all of upstate New York. What has been lost is the organizations that I work with, the housing counseling organizations, the organizations that are doing redevelopment of properties and rehabbing of properties, don't have those direct connections with the major institutions. Their relationship really now is getting a $10,000 check once a year, a $20,000 check, or what have you.

I will just also mention that the issue of REOs, which I think we might touch upon a little, that's a very real issue. In the last couple of weeks, two different neighborhood groups have come to me saying, there's a key property in our neighborhood, it's coming up for auction, and we're really worried it's going to go to an investor. Is there anything we can do? Unfortunately, because of the loss of strong CRA representation in the communities, my response is, "Well, I'm going to the CAC meeting, and I'll see this guy there who's with that bank, and I'll talk to him about it." I'm sort of transitioning to the next topic, but I think it's really an important piece to try to solidify that process.

MR. NARAIN: Thank you, Kirsten. Mark.

MR. WISEMAN: I want to start with a story, unfortunately, for some of the people here that have heard it before. Several years ago, I was sitting at a table with the president of Ohio Savings Bank, which no longer exists, and he indicated to me that he had stopped lending money inside the city of Cleveland. And I said, "How do you comply with CRA?" He says, "Well, that's easy, we just figure out how many loans we have to make, and then we pay Countrywide to get the loans for us, and we take their loans." So, in effect, what was happening was that this banker was admitting to me openly that they had found a way to skirt CRA, and they did it in what I think is probably the worst way possible, which was to pay a subprime lender to go in and take their business.

For those who like data as well as anecdotes, I have a series of maps. If I put them on a PowerPoint, you'd all say ooh and ahh, if I showed it to you, because it's a very interesting effect in the maps. But in 2005, the non-regulated lenders were at the clip of about 85 percent to 90 percent of all the loans in Cleveland, Ohio. During the same period, the depository lenders had the other 10 percent to 15 percent. Then you take the map forward to 2006, and the foreclosure map is the exact map, a mirror of the exact map of the non-depository, non-CRA lenders inside the city of Cleveland. However

CRA works, whatever its intention was, the city of Cleveland was gutted by lenders who weren't bound by it and abandoned by those who were. Whatever caused that, I think, is beyond the scope of our discussion today, but I think everybody who has a serious discussion about CRA in the future needs to sort of understand how that happened and why that happened.

There's a lot of discussion about let's give banks credit for dealing with REO properties and for all these other things. You're certainly going to hear a lot of ideas about how to expand CRA to give banks more credit. That's a fantastic idea, but I think banks should also get demerits for participating in behaviors that gut the very same neighborhoods that they're getting credit for rebuilding. If a bank has a high foreclosure rate and a corresponding low loan modification rate, if a bank finances payday lenders, either directly or indirectly, if a bank is just abandoning an urban area, if a bank is dumping post-foreclosure REO properties to speculators and not fixing them up, those are all concrete ways to destroy neighborhoods, and that, I think, should be taken into consideration as well.

Finally, in my mind, one of the main purposes of CRA is to increase lending and credit products into the low- to moderate-income and minority neighborhoods. I think everything should be decided -- are we achieving this, or are we not achieving this? Thank you.

MR. NARAIN: Thank you, Mark. Mary.

MS. TINGERTHAL: Yes, I want to comment further on Mike's point about investment funds. It's not just for Low Income Housing Tax Credits but also for New Markets Tax Credits and also various loan funds that have been historically administered across networks of organizations and have all provided something that I think we forget sometimes. That is, while bringing CRA credit, it can also bring a diversification of risk from a safety-and-soundness standpoint for the banks of being able to at least make some of their CRA investments not all in the same geographic area, so that they can manage that economic-downturn risk, if you will, of making those investments.

The practical application in the field that I've seen over the last 15 years, there's sort of a landmark ruling of the interagency task force that's probably 15 years old now that making investments in the general regional area was okay. As Mike indicated, the regulators, quite frankly, have been chipping away at that over the years, so now you really do have to earmark a specific project if you're going to get credit for that. I do think that's unfortunate.

To give an example of what that means on the ground, I had a meeting last week of our member organizations that utilize the Low Income Housing Tax Credit. As the credit market is improving, the gulf between pricing in a rural area and pricing in a major metropolitan area has skewed beyond levels that I've certainly ever seen before. The examples we had was that in New York City, you can still garner about 95 cents on the dollar for a Low Income Housing Tax Credit. In Waterloo, Iowa, it's more like 68 cents. There's certainly some reason, good economic reasons, where there should be some spread between those two markets, but that spread is really unprecedented. It does reflect partly on the fact that banks do find it very difficult to invest in the national funds that might be able to go and find those Waterloo, Iowa, or rural Maine kind of Low Income Housing Tax Credit projects.

MR. NARAIN: Thank you, Mary. I can confirm that from the perspective of several banks working in the Mississippi Delta. It's just impossible to find people to invest in those communities, because it's just very difficult.

Jennifer, you had a comment?

MS. TESCHER: Yes, I wanted to build on something Mike said. I thought you did such a nice job of laying out those issues so clearly. I want to go back to the coverage piece. If we're going to expand coverage and think about coverage by product as opposed to by institution -- which I think makes a lot of sense -- we are going to have to fundamentally rethink the test. Because as it is, even those entities currently covered by CRA are extremely diverse in terms of their business models, in terms of their marketplaces, in terms of the size of the institution, and now this proposal would broaden it even further. I think that we need to decide what's most important, what we want this test to really -- what people really need to measure up to at a baseline.

But then I think we really need to give institutions flexibility to meet the test in the way that makes the most sense for their institution's strategy. Because when we just say here's the cookie cutter, you have to do it, you get people following the letter of the law but not the spirit of the law. What you want is for folks to find those community development activities -- I use that phrase broadly, not narrowly -- but those activities that they can excel at, where they can make a difference in their community, but it makes sense for them from an institutional strategy perspective. So, we need to think really carefully about how we design the new test, so that institutions have some room to pick from a menu that's going to allow them to pick the things that make sense for them, where they're located, what kind of institution they are, et cetera.

MR. NARAIN: Thank you. I'm going to call on Dory first, because, Dory, you had some very good comments on coverage of the CRA test and so on yesterday.

MS. RAND: Thank you. First of all, I want to thank the Fed for holding the public hearings. We look forward to participating in Chicago. Also, thank you for the new rule. I haven't had a chance to review it yet, but really like the idea of coordinating with NSP-designated areas and targeting services to where they're most needed, to the hardest-hit communities. It's great to agree with my banker friend, Mike, and to see this growing consensus that if institutions are offering the same kinds of products and services, there needs to be a level playing field, whether you're talking about consumer protection or CRA. I certainly support the idea that we need to expand coverage, both geographically and by institutions. I think some of this requires statutory changes, like the coverage of institutions, but other things, like the REO NSP rule, can be done in the interim. And I think there are other things we could continue to do in the interim.

As far as the coverage goes, in addition to covering areas where the institution has a branch or a retail outlet, one proposal out there under the CRA Modernization Act would be to also cover areas where the company has .5 percent or more of the total amount of loans or market in that industry. You could apply that not just to deposit-taking institutions but to investment firms, mortgage companies, insurance companies, credit unions. That's a standard across the board.

Another thing I want to mention is the importance of strengthening the service test. I think that the traditional way of just going by where you have branches and ATMs is very outmoded. Particularly as we have evidence now from the FDIC survey about the millions of people who remain unbanked or are formerly banked, and the critical first step of getting a basic checking and savings account, there needs to be more emphasis there. If that means shifting the percentage of the test, maybe that needs to be done. As Jennifer mentioned, a lot of people, including small business owners who are trying to get credit, have blemished credit histories, and they need things like second-chance accounts to get back on track. So, I really look forward to the hearings and to the opportunity to work with you on interim rules and, ultimately, I hope, to the passage of the CRA Modernization Act.

MR. NARAIN: Thank you, Dory. Shanna.

MS. SMITH: On the part of the issues related to the foreclosure crisis and CRA, some of the things that I think we ought to consider is, are the lenders paying the taxes on the REO properties in a timely way to the municipality? Are they taking action on nuisance abatement and maintenance of the properties that are located in minority and low-income communities? I think there has to be some exploration about foreclosure abandonment, particularly in communities like Detroit or Cleveland, cities that have high rates of REO and foreclosed properties.

I guess that would also go to the fair lending examination, but they would get good points under CRA if they could demonstrate that they were paying the taxes, they were maintaining the properties. And, also, some comparison of are those REOs sold to homeowners or given to CDCs to sell to single-family homeowners, rather than investors?

MR. NARAIN: Thank you, Shanna. Lorenzo.

MR. LITTLES: I have two quick points. First, I'd like to commend the Board for the decision to link CRA credits with the NSP activities that are going on. I think that's an important initiative. There have been some fits and starts with respect to how NSP is taking hold, and I think having the Board take this position will create some momentum.

The second thing I'd like to do is commend Mike and Paula for identifying the fact that a lot of the work that is going on in the banks and a lot of the things that they are doing in the community development services bucket is only getting a small amount of CRA credit. From the perspective of the organizations that I've represented, that activity makes a huge difference. To the extent that we can create better incentives for institutions to work on community development activities, I think that we ought to explore that, and explore that aggressively.

MR. NARAIN: Thank you, Lorenzo. Before I go on to incentives, Mary, did you want to talk a little bit about what's happening in the REO properties and the Hope Now Alliance portal?

MS. TINGERTHAL: Certainly. I can't tell you how thrilled I was to hear the announcement about the rules linking the Neighborhood Stabilization Program to CRA. I think it's a real opportunity. I really applaud the Fed for taking a leadership role in bringing this to the point where we can have a public debate about it.

What I did want to say is that while we have made progress in neighborhood stabilization, I feel when I talk about it a little bit like what I hear the Governors saying when you talk about unemployment, that there are a few green shoots here and there, but it's a very, very long road ahead of us. Communities have gotten better about knowing how to have a dialogue with the major servicers. I've talked to you before about the National Community Stabilization Trust, and I'm very pleased to say that the major servicing organizations have embraced that conduit. More and more properties are finding their ways to communities and nonprofit groups and for-profit developers to be redeveloped to start to reclaim these neighborhoods. But the track record is very, very mixed. We have some beginnings of success stories in places like Los Angeles and Las Vegas. But we also heard from Ira yesterday that the city of Philadelphia has done five properties, so we have a long way to go. I do hope that HUD and Congress and the Administration will really put a renewed force behind NSP, and I think that will be greatly boosted by CRA.

On the foreclosure prevention side, which we'll get into a little bit after the break, I think there are also some interesting developments there in terms of the major servicers finally beginning to understand what an incredible allocation of resources it will take. Some innovations in the field, like the Hope Now Alliance's Hope LoanPort, are beginning to bring some of the technological changes that are really going to be needed in order to recognize the number of loan modifications that still have to occur. I have to say, I was really struck this morning by Mike's comment that loan modifications fall within the 5 percent services test. And, no wonder. Thank you.

MR. NARAIN: Thank you, Mary. Kevin, you want to talk about carrots and sticks?

MR. RHEIN: Yes. As I step back and try to think about what we're trying to do, the needs are never greater than now. Obviously, the great recession, and there's so many more products that really could potentially qualify for CRA credit. To me, the question is, how do you focus less on the rating of the exam, and how do you get more dollars from financial institutions into these products?

I would just really encourage the Fed, as they start to think about that, how can you possibly create incentives for institutions to want to do more than just pass the exam, but actually materially boost the investment that they're making in this area? You could do things like reduce FDIC insurance based on the performance of an institution. You could provide tax credits. You could simplify the examination process that they have to go through on their next exam. I would encourage you to think more broadly around either operational or financial ways you can take cost out or expense out of an institution that they could perhaps then turn around and reinvest into other areas. Let's worry less about the exam score, because everybody's doing what they've got to do to get the exam score. There's only 5 percent in different areas that really need the most. Well, you don't want to take it away from some other area -- what you want is a bigger pool. How do we get a bigger pool?

MR. NARAIN: Thank you, Kevin. I'd just like to add one more voice in favor of incentives. Under the CRA and the Financial Institutions Reform, Recovery and Enforcement Act, investments by major depository institutions into minority institutions get CRA credit. There is this new set of institutions the last 15 years called CDFIs, which are focused on supporting low- and moderate-income communities. One of the things, as we move forward, we'd like to see is giving credit to larger depository institutions for investing in or lending to CDFIs because that's their mission, to work with low- and moderate-income communities. Hopefully, that'll help.

MR. CALHOUN: If we can have one or two more comments, and then we need to take a break.

MR. NARAIN: Phyllis.

MS. SALOWE-KAYE: While we're looking at the incentives, I think we also really need to look at the penalty part of it. I think just the inability to merge or to branch, given the times today and how often that is or isn't happening, I think we need to look at other penalties or other incentives to do the right thing, other than those. I think they're a little old and don't apply to the times today.

MR. NARAIN: Thank you, Phyllis. Mike, back to you.

MR. CALHOUN: Thank you for leading that good discussion. We'll take our break now. If everyone can please be back at 11:15, we have packed topics between then and lunch, so we want to give everybody time to get their comments in.

(Whereupon, the proceedings went off the record at 11:04 a.m., and went back on the record at 11:19 a.m.)

MR. CALHOUN: Thank you for coming back quickly because we have important issues. I know this will come as a shock, but if you remember, we have an open session at the end, and I'm running out of paper listing all the names of people who want to speak in that open session. This session is scheduled to go through 11:50. As you think about your open-session remarks, conciseness will be highly valued.

Our next topic is one that's not going away, unfortunately, anytime soon. We had a session on foreclosure issues. The foreclosure numbers continue to set records. Perhaps more distressing is when you look at the underlying data, we are not only not halfway through the foreclosure crisis, there is a huge wave of backlogs of loans with increasing levels of delinquency, both for loans going into the foreclosure process and those that have not yet started the foreclosure process. Patricia has agreed to take on the task of leading this group through this very important topic. Thank you for doing that, Patricia.

MS. DUARTE: Thank you, Mike. Well, let me get started. We did have a lot of good discussion regarding the foreclosure problem yesterday. Let me start by just telling you that we are seeing some progress. I am a very optimistic person, so there is minute progress that we are seeing in the Phoenix metro area. We are kind of celebrating the fact that the foreclosure number in April was 3,500, down from 4,400 the month before in March, but we're still tracking a lot of foreclosures. Many families are still struggling. The scam problem is still increasing, and there's still a lot of work to be done.

I know that we have several people that are going to be sharing their experiences and some of the challenges that we're having with the Making Home Affordable program. We also discussed about the impact that foreclosures are having in our neighborhoods. To get us started, I know Kevin wanted to talk about the new requirements under the HAMP program.

MR. RHEIN: Thank you. One of the questions we discussed was the income verification prior to entering into a trial modification program, and we absolutely believe that's the correct way to go. When the program was originally introduced, that's the way Wells Fargo was trying to do ours, not letting people enter until they could prove the income. Many others were not doing that, and we were getting tremendously criticized for not doing enough trial mods. We adopted others' practices and let people enter a trial without having the documentation. Lo and behold, I think everybody has seen that that just doesn't work very well. There's just a huge number of failures, so we are back as the program now requires, that all the documentation has to be provided up-front. That does remain one of the biggest problems in getting these loans qualified -- getting borrowers to provide the information.

The second thing we talked about is the unemployed. HAMP recently introduced a new program where individuals who are receiving unemployment benefits can essentially go into a suspension period of time where we can work on the modification once they are re-employed. We think that's great, but there are limitations. It's limited to 12 months, and we know from the unemployment picture that many people are unemployed for longer than 12 months. There also are tens of thousands of people who aren't getting unemployment benefits, and there's nothing we can do for those particular individuals. We would encourage the Treasury to continue to look at are there programs that can start to deal with the fact that somebody doesn't have a job, what do we do in those circumstances?

Then, finally, the question was on HAMP principal reduction, and the short answer is, it's too new to rate. There just isn't enough evidence yet to show how much of a positive impact that may start to have or not under the HAMP program.

MS. DUARTE: Thank you, Kevin. Phyllis, do you want to share with us your experience at your center?

MS. SALOWE-KAYE: Okay. Well, we're the largest HUD-certified loan modification center in New Jersey. Like Patricia, I'm a little optimistic, but more overwhelmed with the thousands -- we have caseloads into the thousands.

Some of the things that we are seeing, unfortunately, regarding the HAMP program is a very small number of HAMP modifications are actually becoming permanent. We have a state-mandated mediation program, which we helped develop the legislation for, and actually have set it up with the attorney general's office. We're hearing lenders tell us that their servicers don't participate in HAMP, so people are being cut off right at the beginning. When we go before the mediator or during workouts before they get to mediation, homeowners are being steered into in-house modifications as opposed to HAMP, which causes them to have to put more cash up-front and have higher monthly payments.

We're also seeing that modifications are being rejected on technical reasons, like if there are multiple documents and they were signed on different dates, there's a different date, or if there's like a one day late in returning the documents or one of the documents. It's being thrown out, not as an ineligible modification but as a technical modification. We're also seeing that deals that have been agreed to before a court mediator or over the phone with a counselor then end up being totally different than what was agreed to when we receive the actual documents. That's what we're seeing.

MS. DUARTE: Thank you. Joanne, you want to share your experience?

MS. BUDDE: I'm with Consumer Credit Counseling Service of San Francisco. We have over 100 foreclosure prevention counselors, so we do see a lot of volume, so some of these are not just necessarily anecdotal stories. We have a lot of data. I would agree with Kevin that before the regs changed on June 1, the servicers were getting overwhelmed with all the people that probably were not eligible and didn't qualify for a loan mod, but they were told to just submit everything anyway and see if they were eligible. This really clogged up the system, so that should improve. Even with all that bottleneck of the trial mods, we've seen improvement in the ability of the servicers to handle the volume that we're referring to them.

There is a need for a system that will streamline the process for homeowners trying to get a home loan to get their documents to their servicer. Today when we provide counseling to someone, as part of the process, once we determine that they're eligible or may be eligible, before we disconnect that call, we transfer that homeowner to their servicer and have a three-way dialogue. Then we drop off the call and let them finish it, so we're connecting them with somebody who can help them do their loan mod.

Even with that, 30, 60, 90 days later, we're hearing from the homeowner calling us back saying, can you help me again because I've been sending documents. They tell me they didn't receive them, they tell me they've lost them, they tell me that since I didn't send everything the same day, they won't store anything. I have to start all over and resend the documents. We're still seeing this big bottleneck of people that were on the verge of getting a loan mod, that are just sitting in the system forever because the servicer says they don't have their documents.

We were told that Treasury was going to develop a web-based portal that would allow the homeowner to scan and upload their documents, so that once all the documents are received the file would automatically get sent to the servicer so they could work on that. We don't know what the status of that project is. I don't know if it's been abandoned or what's going on with that project.

There is the Hope loan portal that can be used, but the problem with that is that some of the major servicers have not signed onto that thing yet. If you don't have the bulk of the servicing volume out there, it doesn't make sense for counselors to be doing double data entry to get their data into that, if the servicer that they want to connect with is not part of that. We were just told this week that BofA signed onto that so we're hopeful, since they're such a big servicer, we're hopeful that that'll make a big difference.

One last thing. While it makes sense to have such a portal to make it easier for the homeowner to get their documents to the servicer, a lot of people don't have that technology. Even when you think about it, can they go to their office and do it? But they definitely don't have the technology at home to scan documents and upload them to some site, so that means we're going to be having to send consumers out to some place in their community -- a Kinko's, a FedEx, asking them to do it in their office someplace. That's going to create delays too, while somebody tries to figure out where to go, figures out what it's going to cost them to do that, finds it. As people have talked about the problems in the rural areas, a lot of rural communities and small towns don't have one of those sites in their town, so it is going to create some logistical issues for consumers to try to use some kind of portal like that.

Today, they're faxing, partly because it's secure and partly because they have easy access to fax machines. That still remains one of our biggest problems -- trying to figure out an easier way to get the documents to the servicer so that the loan mod can be completed.

MS. DUARTE: Thank you, Joanne. I know that NHS is one of the agencies that signed up to do the Hope LoanPort, so people will be coming to our office, and we'll be scanning that information. Hopefully, that won't be so much of an issue for some of the borrowers. Mike.

MR. CALHOUN: Yes. This is a somewhat related topic but slightly different, and that is that I think there's increasing recognition that the goals for the HAMP program have been trimmed back. The 3-4 million modifications are not going to happen through the HAMP program. It's going to be much less than that. As we talked about the numbers, I think the good news is, of not being halfway through the foreclosure crisis, is that maybe we can help some more folks before they end up losing their homes.

In the context of the financial reform bill, there had been an amendment prepared by Senator Durbin's office of a modified version of bankruptcy reform that had some differences and changes from his bill that was voted on a year ago to make it more palatable to the banks and also perhaps more fair and more workable. The most significant change was that the previous proposal essentially had an initial modification when you filed the bankruptcy plan, which later became final at the end of the plan. It was designed to stop people from filing. They couldn't file and then walk away with a lower loan balance. They had to make it through the plan.

This significantly changes that to strengthen those protections by fully pushing any modification of the principal to the end of the plan. Two important ramifications of that. First, it means that the institution gets the benefit of any housing appreciation during the plan period, which is typically five years. So, it reduces the incentive of those who might be considering a strategic default, for example -- although the bankruptcy process in itself is a pretty good disincentive to that, and the bankruptcy process has a requirement that you have to prove you cannot afford the loan. You can't come in and ask for reduction in principal unless you can demonstrate an inability to pay.

Second, it has an important accounting ramification in that it does not modify the loan and does not therefore require a write-down of the loan on the bank's books at the beginning of the plan, which is important for two reasons. One, a lot of bankruptcies don't succeed, so you've got this write-down and then a subsequent adjustment later. Second, banks are capital-stressed right now, and not having to do that write-down at this point is an important advantage for this revised process.

So, the amendment had been prepared, it was still somewhat in flux, and then as everyone witnessed, the Senate debate kind of collapsed at the end. It, ultimately, like a number of other critical amendments in the Senate, was never reached. But I hope people will keep an open mind that there are no silver bullets on this. There are going to be a lot of foreclosures. Bankruptcy, we believe, would significantly help. It's not a silver bullet, but it is a significant additional tool, and we need additional tools. I'd urge people to keep an open mind about ways to look at that and revisit it and see if there are ways to adjust it.

One final way that has been discussed is to create an additional path, likely for legal reasons, constitutional reasons within the bankruptcy titles, but separate, for example, from the existing Chapter 13, so that the home modification would not automatically pull people into Chapter 13. It wouldn't disqualify them for that, but you could address just the home loan and have a separate discrete decision about whether other debt was restructured as well.

MS. DUARTE: Thank you, Mike. I know Andy has some comments.

MR. NAVARRETE: Sure, just following up on Mike's point, I completely agree that we certainly need to expand the arsenal of tools available to us to look at alternative ways to modify these loans, just given the challenges with some of the current programs. I do want to caution that I tend to believe that bankruptcy, and cram-down in particular, tend to be very blunt instruments. You talked about the sort of more surgical approach there at the end, which is certainly worthy of dialogue. But the use of bankruptcy in this context for loan modifications could have a number of unintended consequences, particularly around other forms of consumer credit where the customer may continue to be current, such as auto loans or credit cards.

One phenomenon that we have seen certainly in the market today and through this recession is a shift in the conventional wisdom on payment hierarchy, where mortgage used to be presumed to be number one on the list. With so many underwater borrowers, it's actually fallen behind auto and credit card in terms of the payment hierarchy. The reasons for that are fairly logical, if you think about it, which is that a car and a credit card are both essential sort of tools in a modern economy, whereas in housing you have options, such as renting or others. I would just say I would not want to see bankruptcy used as a tool, if the consequences for other forms of consumer credit were as profound as they could be.

MS. DUARTE: Andy, thank you for those comments. You said something about payment priority that just reminded me that there is really a lot of exhaustion that the families have been going through for many months, some over a year. One particular incident that I remember, after a year and a half of trying to save their home, this particular family just decided saving it was not going to be worth it, and the relief that they're feeling from having exhausted every single resource is, I think, going to become a trend that could hurt us all in a bigger way, because every foreclosure continues to decrease values in Arizona. In Maricopa County specifically, the values that we had in 2005, the median price was $240,000; in 2009 the median price is $140,000, so a $100,000 decrease.

That's the battle that we're fighting, continuing to fight because this negative equity is a big problem across the board -- those that are being hurt, and those are fine with good modest means. But that question of why should I stay when there's such negative equity -- the principal reduction program I know is still very new, but we're hoping that that will help more people to stay, if the lenders and servicers buy into that principal reduction program. I know Saurabh has some comments to make.

MR. NARAIN: Sure. Thank you, Patricia. Recently, I was talking to a friend of mine who's the chairman of the Department of Finance at Santa Clara University. He's doing a lot of work relating to foreclosure prices and credit pricing issues. I was generally chatting with him about the HAMP program, the fact that there are so few permanent modifications, why redefault rates have increased, and so on.

He has published several papers, one of which basically says that the reason that's happening is because loan modifications actually create put options, increase incentive to the borrowers to redefault. One of the ways in which we can actually further the cause of loan modifications, improving the financial crisis, is actually to do write-downs in principal. He said that is perhaps a key next step that the regulators and Treasury need to think about in resolving this crisis. I'm happy to circulate the research. There's a lot of Greek and theory in it, but the key conclusions were very important for me to hear about, and I'd urge the Fed to sort of think about that in this context.

As I walked into the meeting yesterday, I heard about the principal reduction alternative. I'm very keen to learn more about that program and how it ties together. I look forward to that.

MS. DUARTE: Thank you, Saurabh. Jim.

MR. PARK: When it comes to foreclosure issues, I am cautiously pessimistic, not optimistic. I really do feel that we are nowhere near done. I think as Mike suggests, we're not halfway through the crisis yet, so I think we still have a long road ahead. Clearly because of HAMP and other efforts by the industry, there has been a temporary kind of reduction in foreclosed homes in the market. It has led to the situation, like in Patricia's case in Phoenix, of REO inventories actually going down. You have multiple bidders coming back into the market, and it's creating the sense that the market is healthy again, or it's normalizing again.

The fact is, I think we are nowhere near there. If you talk to most servicers and lenders out there, most of them expect a pretty decent chunk of REOs to be flowing back out into the market probably by this fall, so I do think we have a lot more work to do. I think the innovative ideas, like bankruptcy reform or principal write-down, we still have time to implement new ideas and come up with new ideas. I think what I would suggest is, as a group and as an industry, we keep the foot to the pedal, keep thinking about new ways of slowing down the foreclosure flow, also creating ways to help people modify their loans or reduce their principal payment structure, because I do think it's going to be a cycle that's going to be around with us for another three years at least. Right, Mike?

I think being optimistic, it would be three years. I think being pessimistic it might go out maybe a little longer. But it is something that's going to be with us for a while. I think we'll be talking about it in the Council meetings ahead, if there are more Council meetings ahead.

MS. DUARTE: Thank you, Jim. Kirsten.

MS. KEEFE: Well, that's actually a little bit hopeful for me, because I was thinking that, wow, we're having the same discussion about HAMP that we had a year ago, so at least it puts a little expectation that we might be having the same conversations about HAMP a year from today.

Before I talk a little bit about HAMP, though, I just want to say that I agree with Saurabh. I think principal write-down is a necessary piece, not on all loans, not across the board, but I think there's enough research and reading that I've done that I have come to believe that I think principal write-down in any way, and I've been brainstorming about how you can effectuate that.

I think the bankruptcy model that Mike Calhoun discussed is a great model. I don't know if you mentioned it today, but I know you mentioned it yesterday, another benefit of that in terms of waiting to do the principal write-down if somebody were to enter into a Chapter 13 bankruptcy, not doing it now, but doing it in five years, is that the lender would also have the benefit of potential appreciation of the property in five years, which makes a lot of sense to me. Again, I don't think that's the only way that we need to look at potential principal write-down, but I think it is a pretty logical idea.

I have also seen improvements that Patricia has seen, although not marked improvements. The improvements have been here and there. The dance that we keep talking about -- there's certainly a big dance that continues between homeowners and servicers. Homeowners are still getting their toes stepped on, but I think the servicers continue with maybe two left feet, and they need to be given a left and a right foot. A lot of the systematic issues of HAMP need to really be addressed by Treasury.

I was very heartened to read the April oversight report from the Congressional Oversight Panel that they came out with in April of 2010, and thank the Federal Reserve for providing that to us in our reading, because it just puts down on paper a lot of the day-to-day stories that I am seeing that homeowners are experiencing, as well as what I'm hearing about from service providers throughout the state and throughout the country. I really encourage folks that are looking at HAMP to read this report, because this is real and they really highlight a lot of the issues that are ongoing.

The issues that are ongoing that are highlighted in the report are continued customer service problems. I still get homeowners that will receive completely contrary letters to whether or not they've been approved for HAMP within a week's time. Delays in HAMP applications, and all of that absolutely is continuing. The second liens continue to be a problem -- that's highlighted in the report, and other things.

The report on page 55 highlights the issue of denials, and that is a major issue. It says, "The panel is deeply concerned about the unacceptable quality of the denial and cancellation reasons, and strongly urges Treasury to take swift action," et cetera. That is one issue that we've really identified as a big problem -- that people are being denied, they don't understand why they're being denied. We believe they're being denied for false reasons. The appeals process remains still very bad, and we fear that a lot of people aren't actually getting the modifications who should be getting the modifications.

Some additional issues that I didn't see highlighted in the report that we're seeing, and Phyllis mentioned this, folks are still being denied because the investors aren't participating. Fortunately, in our state we have mandatory settlement conferences now as part of the foreclosure process, so we're able to press that reason and actually request pooling and servicing agreements to see how truthful those initial statements are. Often they aren't. But that still is sort of a common reason or knee-jerk reason that a lot of people are hearing.

There are real credit reporting issues, folks are being adversely reported on credit reports even six months into a permanent loan modification. We recently had an example, so that's a real issue.

In upstate New York, a lot of folks that I see actually have equity in their houses. The report talks about how people are falling behind because of curtailment of income more so than because of a bad subprime loan product. We are seeing a lot of folks that have good mortgages. They got their mortgages not in the subprime boom. They still have substantial equity in their house, but they are falling behind because of employment. They will automatically be denied or fail the HAMP NPV (net present value) test because they have a lot of equity in their house. I do wish Larry Litton was here because I imagine he might agree with me on that. He mentioned in the last meeting some of the fundamental flaws with some of the inputs of the NPV test, and I would love to ask him directly his opinion on that, but we're certainly finding that.

Finally, another issue that we're seeing is that this whole loan modification and foreclosure process is really generating this whole other issue with foreclosure mill firms, fees. We're seeing upwards to $3,000 right after a complaint is filed in fees that the homeowner has to pay. I firmly believe those fees could be contested in court, but for a homeowner to navigate contesting $2,800 in legal fees at risk of holding up the process of getting their loan modification, there definitely is a cost-benefit analysis for them to weigh, and it's difficult to negotiate those fees. Most homeowners, I think, are just resigned to signing the loan mod because they're finally getting it and they want to move on with their life, but they're paying really expensive fees that they shouldn't be paying.

MR. CAREY: Those are fees from these debt mills, not from the servicers. Is that right?

MS. KEEFE: Well, technically, the note requires that the homeowner is responsible to pay the lender. Right? If somebody defaults on their loan, the note will say that the homeowner is responsible for reasonable and actually incurred fees. So, the borrower is actually paying to the lender these fees. I've often argued that the mills, I don't really care what you charge your client, the lender, to foreclose. You can overcharge them all you want, but my client has a contract with the lender, and that's who the money is owed to, so the borrower is paying to the lender the $2,800 in legal fees. I agree that the dollar amounts might be generated by the foreclosure mills, but my client is not paying it to the mill. They're paying it to the lender for your high cost to reimburse the mill.

MR. RHEIN: So, you're saying those attorneys are charging the lender, and the lender is including that as part of the fees?

MS. KEEFE: Yes. And you get a payoff statement.

MR. RHEIN: The lender didn't hire the attorney.

MS. KEEFE: Yes. Well, the lender or usually, I think, it's the servicer that actually has the contract on behalf of the plaintiff, the owner of the loan.

MR. RHEIN: It's a provider that the servicer hired.

MS. KEEFE: Yes.

MR. RHEIN: Okay.

MS. KEEFE: On behalf of the plaintiff.

MS. DUARTE: We have room for maybe one more quick comment. Kathleen.

MS. ENGEL: I just want to go back to the principal write-down discussion. It's interesting that that's what we're talking about because back in 2007 there was a move to have across-the-board principal write-downs, and that didn't happen. At the time, people really thought that creating a system of incentives would solve the problem, and that's how we came up with, first, the Hope Now program and then later HAMP and things like that.

It seems to me that the second mortgages, among other things, are continuing to be an impediment to modifications. Principal write-downs may be what we need to do to create the incentives for loan modifications, particularly if the second lien holders are the holdouts in this process because they stand to lose everything, or it's very likely they stand to lose everything in most cases if there are principal write-downs. So, principal write-downs may fix the incentive problems that exist with the current structures.

One thing that we talk about a lot here at CAC is the effect of different policies on consumers and on lenders, but we don't really talk about the externalities that are borne by people who had nothing to do with the problems that exist in the economy. Most people didn't take out reckless loans, and most people in this country are seriously affected by the reckless lending.

We all, almost probably all of us, lost tremendous value in our homes over the last few years. We're seeing incredible dislocation of children. I hope people have seen some of the new reports that have come out on the number of children who are now getting picked up at homeless shelters for school, at RV parks, and things like that. And studies on the impact on children's education, increased teen pregnancy, increased drug use, lower rates of high school graduation -- these are costs that are borne by the society. They're borne by the people who had no responsibility at all for the economic crisis.

In contrast, many banks bear responsibility for the reckless lending. They got TARP money. They're getting paid to modify the bad loans that they made. The question really is, who should bear the costs? Should it be the people in the society who had nothing to do with getting bad loans, or should it be the banks who engaged in the reckless lending? I think the answer is pretty clear, that with principal write-downs, the loss is being borne by the entity that was primarily responsible for what went wrong. It's better that those institutions, even if some of them were completely innocent and not involved, but it's better that they bear those costs than the millions and millions of Americans who had absolutely nothing to do with the creation of this market, never took out a bad loan, were good lenders, savers, the people who really are supporting this economy and exercise good judgment.

MS. DUARTE: Thank you, Kathleen. Back to you, Mike.

MR. CALHOUN: Thank you for leading that discussion. At this point, we turn to the part of the program where people can make comments on a variety of issues. Again, we have a large number of people who wish to talk, so I'd ask that they be brief in their comments. Jennifer, if I can start with you, please.

MS. TESCHER: Sure. Last week, my organization held its annual conference, the Underbanked Financial Services Forum. There was actually someone from the Federal Reserve Board in attendance, along with several hundred banks, credit unions, technology companies, non-profits, other government actors. These are all entities that in some way, shape, or form have proactively chosen to serve underserved consumers. It's particularly meaningful to me when sort of the can-do crowd steps up. During the conference, I think there was a running theme to complain that they, on the one hand, hear regulators, particularly the leaders of the regulatory agencies in this country, saying all the right things around wanting to provide additional access to consumers, responsibly, but that we should be encouraging that. We just had that conversation earlier today on small business, as an example, and I know you all have been quite outspoken on that topic. But they hear that on the one hand, but then when it's time for their exam, they hear quite a different sentiment from examiners.

This isn't a new story. Right? We've always heard this story before. But I think it's particularly important now in the context of regulatory reform, where we're having these conversations about how do we balance consumer protection, safety and soundness, and access, which, in my mind, is sort of the third leg of the stool. Also in the context of the dramatic changes in the broader financial services industry, where underserved consumers are even more so now.

As an outsider, this feels like somewhat of a solvable problem. It feels a little bit like it's a left-hand, right-hand problem, and that there must be more we can do to make sure that examiners are getting the memo from the top and are trained effectively. But I absolutely believe that there are also instances where it isn't clear what the priority is, or what takes precedence, or how to meld equally important priorities. I think those are discussions that we really need to be having in this moment, so I just wanted to make you aware of what some of the chatter is out there. Thanks.

MR. CALHOUN: Thanks, Jennifer. Andy, you wanted to raise a topic?

MR. NAVARRETE: Thanks, Mike. Just to put a coda on our discussion of small business. Perhaps sounding a bit of a cautionary note, I think that the discussions around how to sort of revitalize the small business lending market are absolutely critical, and we certainly heard studies and data suggesting that small businesses are critical to job creation and the current economy and certainly critical to our economic recovery.

I was very heartened to learn that the Fed is working very closely with the SBA and the recommendations for creative ways of addressing some of these issues. But I do worry a bit about some of the rhetoric around the benefits of small business with respect to job creation and economic recovery are starting or could potentially start to sound like some of the rhetoric around the benefits of home ownership back in the `90s and the 2000s. Home ownership -- obviously a very critical element of our society, a critical element of neighborhood revitalization, improvements in schools, reductions in crime, et cetera. But we probably got to the point as a society where some of those things were held to be such truisms and were somewhat ungrounded in certain instances that it drove policies that then reduced underwriting standards and encouraged irresponsible lending.

I worry that we could potentially head down that same path in the small business market if we're not more cautious. I would encourage the Board, which sits in, I think, sort of a unique position of credibility and balance in this issue, to continue to work with the other agencies and the policymakers and the Administration and Congress to ensure that the solutions in the small business market don't lead to documentation-reduction requirements or relaxed underwriting standards that could precipitate another crisis.

MR. CALHOUN: Thank you, Andy. Phyllis.

MS. SALOWE-KAYE: Yes. At our last CAC meeting, we spent a lot of time discussing RALs and their harm to the folks who are getting them and the lack of the ability of the money to go back into the communities, as opposed to going to the income tax preparers. This is my second meeting. It wasn't on the agenda, we didn't discuss it. So I guess my question is, does the Board have any plans on making these horrible things illegal, rapid returns that cost a lot of money.

MR. CALHOUN: Okay. Thank you. Kevin, you wanted to talk about interchange fees and --

MR. RHEIN: No, I'll let it go if others have more important things to say.

MR. CALHOUN: I think we have time for you, if you want.

MR. RHEIN: I know the Board, technically, isn't supposed to get involved in legislation. I do want to encourage the Board through any conversations they can have around regulatory reform -- the Durbin amendment will have a significant implication on the payment system and also on the price of checking accounts. I think the Board does have a clear prerogative into understanding the implications of legislation on the payment system. If you reduce the debit interchange, which drives a tremendous amount of income for organizations that allows investment in new products and services, mobile banking, bill pay, Internet, phone service, ATMs, et cetera, I think you will see those revenues will need to be recovered. And they'll have to be recovered by increases in checking or lack of access for individuals into the traditional payment system, to say nothing of prepaid cards and everything else.

MR. CALHOUN: A topic that we received a very interesting report on yesterday was automobile lending. A couple of people wanted to make comments on that. Corey, I think you were one.

MR. STONE: I wanted first to thank Kathleen and Andy, chair and vice chair of the Consumer Credit Committee, for putting that on the agenda. It was eye-opening how important that segment is, and the staff presentation was terrific, and I would add colorful.

(Laughter.)

GOVERNOR TARULLO: Our staff was colorful?

MS. BRAUNSTEIN: It was a New York Fed guy who specializes in auto.

MR. STONE: It highlights some things that I think we ought to continue to focus on in this group, and I hope we will do so, not only the size, but given the importance of cars to people's livelihoods and access to work, and also given what's happening in other sectors of credit, particularly credit cards with underwriting standards tightening, with the Credit Card Act potentially delaying acquisition of cards, the car loan will become an initial source of credit for more people, or it will be the first kind of credit that people try to apply for. We need to be thinking about ways in which people can get access to affordable car loans, when they haven't gotten a credit history in what has recently become the traditional way, which is by getting credit cards, and how to make those affordable.

The most compelling aspect of yesterday's presentation was the description of the nature of the indirect market and its lack of transparency when individuals try to obtain car loans through the dealer. As a bank, we are very interested in making car loans. We see it as a perfect place for getting people to prepare for a car loan by building savings for a down payment. We think it's important for the overall relationship. But we can't compete against the dominant distribution channel where there is no basis for comparing terms. So, we can't deal with an educated consumer.

I think the evidence out there is that the direct loans perform better, they're more conservatively underwritten, there's more likely to be a down payment. Certainly, the customer satisfaction is higher, so we'd like to take a bigger chair in the traditional retail depository.

A number of us were so moved by what we heard yesterday that individually we're signing on to a statement to send to Senator Dodd to make sure that the auto dealerships are included under the CFPB, which certainly based on what we heard makes all kinds of sense. Thank you for including that yesterday, and I hope we can find more ways to bring more access and affordability to that sector.

MR. CALHOUN: Mark, you also wanted to comment on the auto lending presentation.

MR. WISEMAN: Yes. Thanks, Mike. We discussed a lot yesterday about how the financial and insurance office of an auto dealership is set up, not to offer products to consumers they can use when they buy a car, but to stick them with as many extra costs as we can have. The presenter was a gentleman who spent the greater part of his career as an F&I officer in an auto dealership. Certainly, now it's more important because all the people who are going to be renters from now on, the car loan will be the largest loan that they have. As several people around this table have commented today, this is the only loan that people are continuing to pay, when all the other loans are going into default.

We could not come to a consensus yesterday about how everybody felt, whether they supported this exclusion for car dealers or not. We couldn't even come to a consensus on whether or not the word "outrage" was an appropriate word to use.

I will tell you that to allow car dealers and car loans to have an exemption under the consumer financial protection legislation is a bit like regulating future drilling in the Gulf of Mexico, but allowing the company to have an exemption, let them to not be bound by the regulations for one reason or another. I don't know whose quote this is, but the idea that "all that's needed for evil to thrive in this world is for good people to stand by and do nothing." I would say that we're obligated not to stand by and do nothing. In my office, we joke that the solution to the financial crisis is really a time machine. If we could only go back and get into a time machine and figure out everything, we could solve everything. But we don't need a time machine now. This hasn't happened yet. I would caution the Board not to stand by and do nothing, especially since this animal will be a Federal Reserve Board item, at least that's my understanding.

GOVERNOR TARULLO: It will not be.

MR. WISEMAN: Not be located inside the --

GOVERNOR TARULLO: It may be, but we have no authority. Everybody needs to understand that. Under either the House or the Senate bill, Betsy, Ben, Kevin, Don, Janet, and I all have no authority over consumer regulations once the bill is passed. I just want to make sure everybody understands. It may be physically located in the Board, but we will explicitly not have the authority to oversee it. It's a bit confusing, but that is the fact.

MS. BRAUNSTEIN: All we do is write the check.

MR. WISEMAN: In any case, it's my opinion that whatever anybody can do to erase this exemption, I think certainly makes this better going forward. Thank you.

MR. CALHOUN: Is there anyone else who wanted to comment on the auto presentation from yesterday? I would note there is one just extraordinary anomaly in the language that passed the House. It would create an island of Truth in Lending regulation for car dealers only to live still at the Fed, so that a car loan written for the auto dealers would be covered by the Fed's Truth in Lending rules. There would be a different set of Truth in Lending rules for anyone else who did a car loan – the beauty of legislation.

MR. CAREY: Just one thing. The only exception I take with what Mark said -- my sense was that there was a general consensus among the members here that we all expressed the same concern. It really was more of a procedural issue about what the role of the Council is and what the Council should do or not do. But I don't think it related to the substance of the issue. I think we all kind of came out in the same place.

MR. CALHOUN: Thank you for that clarification. Mary, you wanted to add some comments on another issue?

MS. TINGERTHAL: I do. I just wanted to take a minute to thank the Board for really giving the staff to the CAC the degrees of freedom to bring emerging issues to us for review. Notably yesterday was the mobile banking presentation that we had. I can think also of the presentation that Jennifer presented to us last year on stored value -- I'm sorry --

MS. TESCHER: Prepaid.

MS. TINGERTHAL: -- prepaid cards as an alternative banking source. I just think it's really commendable that the staff is really looking to where the future issues are. They may not be huge yet. But to imagine that there will be implications for the banks that you and the other regulators are responsible for, and getting them on the table now so that we can not have to use time machines on some of these new things that we know will be on the horizon. So, thank you for having the agenda have the freedom for us to look at those issues.

MR. CALHOUN: Kirsten, you had some similar comments, I believe.

MS. KEEFE: Yes. Yesterday, we discussed new proposed rules regarding the garnishment of exempt income, which actually the Federal Reserve is not involved in proposing. It was among the proposed rules from Treasury. But I think it's a critically important issue, especially for lower-income folks receiving exempt benefits. It's been a huge problem, and I really appreciate that the Board solicited our comments on it.

The Board has also looked at other issues like loan modification scams, which I would say aren't necessarily under your purview or otherwise, but it's a big consumer issue. I think it is important for the Federal Reserve to look at issues beyond your immediate scope, as you have done, because no financial services occur in a vacuum.

In that context, I just want to raise the issue of debt buying and debt collection as a huge issue. I wish I could say that it's emerging. It has emerged, but it will emergingly get bigger, and it's a really critical issue. An organization in New York City -- actually, Sarah Ludwig's organization, the Neighborhood Economic Development Advocacy Project -- along with some other New York City organizations recently did a report on debt buying and debt collection, and they calculated statistics on the numbers and how big of a problem it is. But they also identified how much of a civil rights issue it is and how it particularly impacts lower-income neighborhoods. I just want to put that out there as a potential issue to consider in the future.

MR. CALHOUN: Thank you. Kathleen, you had some comments on another topic?

MS. ENGEL: Yes, Mary said a lot of the things I wanted to say, so I'm going to be brief. It's very exciting to me the extent to which the Fed is involved with technology. I never would have guessed that I would learn something about cell phones from the Fed, so that was great. Maybe I will now activate that Internet piece on my phone. I don't know how to do that, but I know I can do it. Also, the extent to which the Fed is engaged in a lot of interagency work is really exciting and feels like something of a shift. I think, as a result, there's more information out there and more discussion, and it's very exciting.

I also just want to, again, as we say at every meeting, thank the staff. Whatever happens with the consumer affairs folks, I certainly hope that we don't lose their knowledge, their skill, their commitment. It's really been invaluable. I also hope that, given the short time frame that the consumer protection authority is going to be vested in the Fed, if there's any way that you can call on the CAC folks, I'm sure I speak for everybody, for help in getting things through, getting information, things like that, I think we all would be very willing to help and excited about what you're doing.

Along those lines, I feel like there's some unfinished business, and that involves the real-time posting of debit card transactions. We talked about this a bit when we were talking about the different regs that have gone into effect now. I just want to keep this issue alive, particularly given what we heard from Ren Essene yesterday about the mobile banking. I think that real-time posting becomes even more important as new technologies develop.

MR. CALHOUN: Saurabh, did you have additional comments, or were they all covered in the previous -- okay. I'll turn things over just a minute to Jim for some comments, and before doing so, just comment on how active he has been, much more so than a usual vice chair. You'll be in very good hands, whatever happens next year. Jim.

MR. PARK: We might not have any meetings next year.

(Laughter.)

MR. PARK: Mike, I want to thank you for your leadership as well as the CAC staff. At the beginning of the year, Mike really wanted to go out and have some hearings, be more of an activist organization or Council, and I think he has done that. We're excited to do the HMDA hearings, now the CRA hearings. Who knows we may come up with another hearing, so we'll be on the road constantly this summer. But I think that's what this organization is about -- about going out, hearing what's happening on the ground, and taking those issues and bringing them back to the policymakers and the rulemakers and others who are going to affect the lives of people throughout the country.

We have covered a lot about keeping people in their homes -- a lot of issues around foreclosures, all those issues. I do think we do need to focus a little bit more on getting people in their homes again, because I think some of the credit availability issues, financing issues have been slightly underrepresented because of the largeness of the other issue. But I think with FHA, Fannie, Freddie representing what, 90, 95 percent of all lending in this country, their actions and reactions to the market are having just a profound impact on financing, how people can get into their homes.

I'm going through the process of financing my parents' home right now, and it's a lot tougher than I remember a few years back. But I can imagine people trying to get back on their feet, getting back into the housing market, how hard it must be. I think it's something that we should all clearly look at in the days and months ahead. That's all.

MR. CALHOUN: I have two things. First, I want to comment on a substantive issue that is before the Board and in the process of implementation, and that concerns your overdraft rules, which go into effect for both new accounts and existing accounts. I was struck by this recently. I was on the web looking at the *New York Times* last Sunday, and I was rather surprised to see the ad next to the *Times* was for a firm, a well-known one, to help banks solicit opt-ins for overdraft programs. I couldn't resist and clicked on it, and it unabashedly said, make sure that you target the high users. Those are the critical customers for you to get the opt-ins for. To put that in a more personal context, the FDIC study on overdrafts showed for low-income high users, what a high user of overdraft is, they paid an average of $1,600 a year in overdraft fees. This is out of a low-income budget. That was the average for a low-income, high overdraft user.

Then I was struck by the advice that the company gave as to how to reach people for opt-ins. They warned, for example, that people don't open their bank statements -- I think they gave a figure of about 30 percent -- that you need to have an aggressive program, you need to have your tellers and everyone when they're engaged in in-person transactions, you need to have repeat contacts if you're going to be successful. I compare that to the philosophy behind the current Board proposals, which explicitly were not meant to be the last actions of the Board, but the centerpiece of the Board's proposal for dealing with abusive overdraft fees is relying on disclosures in the bank statements. There's a disconnect between what the for-profit marketers think works versus that approach. I would just urge the Board to stay vigilant. There is a dichotomy that seems hard to find the reason for, when you look at over-the-limit fees, which bear similarities in the credit card world, where consent is just the beginning. But there, by statute, the fees have to be reasonable and proportional, which we think is a good standard also for overdraft.

We believe that there's other existing precedent and, indeed, existing guidance from the regulators. The FDIC has looked at similar repeat use of high-cost lending in the context of payday loans and came up with standards that said there needs to be a limit on excessive use. The joint guidance from the Federal Reserve and others provides that same guidance on overdraft right now as to both cost and excessive use. We would urge you to continue to move forward in that area. If the private marketers are right, there's more work that needs to be done there.

Then my second comment is to echo and reinforce the praise for your staff, for Joseph, Jennifer and Shalyce, who work directly with the CAC, how much assistance they provide and really keep the whole system going. And I think everyone here is just repeatedly wowed with the quality of the presentations from the staff on all the issues, both the questions they frame and the information that they provide. You, obviously, know how to hire and keep very good staff.

I think we discussed all of the issues either in the earlier sections during open comments that were presented. So at this point I would just ask Governor Duke, who has been our liaison and leader on consumer issues, and Governor Tarullo, if they have any comments, and then we will adjourn, and to remind people we need to stick around for a photo after the meeting.

GOVERNOR DUKE: Thanks, Mike. Let me start by thanking you. You've done a great job of chairing this. We were talking at the break. It's so nice to see -- there's clearly a lot of disagreement here, but it's done in a very collegial fashion. I think the discussions that you have both in the day before and in this meeting are extremely valuable. I think that the different points of view are certainly helpful, and I appreciate your work on that.

I appreciate all the time that all of you put into this and the thought that you bring to each of the topics that's presented to you, as well as all of the time that you spend when you're not here, that has led you to this level of knowledge that you bring. That's probably even more important, so we do appreciate that.

I try to listen in this meetings rather than talk, and I can't tell you how valuable that is. I also appreciate your comments about the staff. The staff that we have here is phenomenal. They are dedicated and extremely talented and led by an extremely talented and dedicated leader in Sandy. What you see there is very much due to her leadership and that of her leadership team, and they make us better every day by that leadership. And, again, not only the people you see, but the people that you don't see who are supporting the people that you do see.

Finally, I would say if you would ever doubt that the things that you say do take hold, I would point to the things that we've talked about today -- the HMDA hearings, the CRA hearings, and the NSP proposal for CRA. Those come directly out of conversations that have taken place in the CAC as well as conversations that I've been fortunate enough to talk to people going around to the Reserve Banks and the Community Affairs divisions.

Certainly, it looks like, based on the way the legislation is headed, that we will no longer have jurisdiction over consumer rules, and it looks like we will also no longer have the CAC as an advisor to us. That in no way diminishes our interest in issues that relate to consumers and their use of financial services because we still will have a huge role both in financial services and in the economy. So, we will want to continue to make sure that we have the mechanisms to continue to hear the kind of information that you provide.

And, finally, I don't normally respond to any one of your comments in particular, but, Jennifer, on this guidance issue and getting the information out, I just want to assure you that we are doing everything I can think of, everything Sandy can think of, everything Dan can think of to make sure that that information is getting all the way to where it needs to get. We have done training, we have done outreach, we have done, as I said, everything we can. To the extent that any of you can think of anything that we should do that we haven't done, we'd very much like to hear that as well. And with that, Dan.

GOVERNOR TARULLO: Let me just piggyback on Betsy's last comment, which is this has been really frustrating for all of us. And Jennifer, and everybody, not just you -- you talk about data versus anecdotes. The thing that we really lack are concrete examples that we can then back-test, if you will, dig into and say okay, was this an instance in which examiners overreacted? We have kind of issued open invitations to banking organizations to come to us and say here's a specific instance.

To be honest, there's been a very, very, very small take-up of that offer, but I'm sure there are instances of this. If we find out what the specifics are, it'll help in tweaking guidance, so that there's an ability to affect the way people are thinking about specific situations, which is probably what we're going to need. I'd associate myself with everything else Betsy said.

MR. CALHOUN: Thank you. With that, we are adjourned, and if CAC members can gather over here to the right for an annual photo.

(Whereupon, the proceedings went off the record at 12:23 p.m.)