TRANSCRIPT OF THE FEDERAL RESERVE SYSTEM
CONSUMER ADVISORY COUNCIL

THURSDAY, MARCH 25, 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
Tino Diaz
Kerry Doi
Kathleen Engel
Patricia Garcia Duarte
Ira J. Goldstein
Mike Griffin
Greta Harris
Brian Hudson, Sr.
Kirsten Keefe
Lorenzo Littles
Larry B. Litton, Jr.
Saurabh Narain
Andy Navarrete
Ronald Phillips
Dory Rand
Kevin Rhein
Phyllis Salowe-Kaye
Shanna Smith
Corey Stone
Jennifer Tescher
Mary Tingerthal
Mark Wiseman

Others present:
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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9:01 a.m.

MR. CALHOUN: Good morning, everyone, and welcome to our Thursday meeting of the Consumer Advisory Council.

First, I would like to thank and recognize Governor Duke, who oversees the activities of the Consumer Advisory Council and has been supportive in a lot of ways, and thank her for all the time that she provides to us.

Chairman Bernanke who, as you know, joined us for dinner on Tuesday night, usually attends our meetings but was called today to testimony on the Hill and could not join us and sends his regrets for that.

MS. BRAUNSTEIN: He would much rather be here, I'm sure.

MR. CALHOUN: I bet he would. He would trade places, right, Sandy?

MS. BRAUNSTEIN: Yes.

MR. CALHOUN: This is the first meeting for a number of new members -- a third of our class that comes in each year -- and I would like to just briefly recognize everyone there.

First, we have Joanne Budde from the Consumer Credit Counseling Service in California, who deals every day with people who are experiencing firsthand the challenges of the financial crisis.

And then next, Tino Diaz, who has 30 years experience now plus in banking and is previous chairman of the National Association of Hispanic Real Estate Professionals and brings a lot of valuable expertise.

Kerry Doi, who is in employment training and assistance, an area that clearly is at the front lines of what we are going through now.

Mike Griffin, from KeyBank, has got a lot of experience at the bank in CRA and came from community development prior to his work there.

Brian Hudson, of the Pennsylvania Housing Finance Agency, has, again, a lot of relevant experience and particularly has a lot of expertise with the Homeowners’ Emergency Mortgage Assistance Program that Pennsylvania has pioneered and other states are looking at now, as well as the Treasury Department.

Dory Rand from the Woodstock Institute. In fact, it was interesting at breakfast, we were talking and had just been, not too long ago, on a trip in France -- the same trip that Sandy had been sharing experiences with French regulators on CRA programs and HMDA data gathering.

Phyllis Salowe-Kaye comes from New Jersey Citizen Action and is really at the front line of families coming in facing foreclosure, facing the financial hardships, and has already added a lot and is a good outspoken advocate.

Corey Stone, from the First Community Bank of New Haven, brings an important perspective that I think we need. The community banks, I think, sort of feel like they have been caught in the middle of not causing the crisis and yet have to deal with the repercussions of it.

And then, finally, Mark Wiseman from the Ohio Attorney General's office. And Mark, I remember going to a group of attorneys general, and his work reminds me of this. One of the guys asked what did he do and he actually worked on elder fraud claims where people were trying to target consumers. And Mark is in sort of the current version of that -- he deals with the mortgage rescue scammers and faces the challenge of chasing them across multi-state lines.

So welcome to all. They contributed a great deal at a very good meeting that we had yesterday.

Governor Tarullo has joined us, and we thank him for taking the time to sit in on the meeting with us, as he has done, I think, with most of the CAC meetings since he has been a member of the Board of Governors.

We will shift now to discussion of some of the many topics that we covered yesterday. The Credit Card Act that was a revolutionary change in the regulation of credit card transactions and credit card issuers was signed into law last May. It included, not surprisingly, a lot of rulemaking responsibilities for the Federal Reserve.

Earlier this month, the Board proposed amendments to Regulation Z, and that's the third stage of regulations that the Federal Reserve has had with the implementation of the Card Act.

Those regulations focus on requirements in the Card Act that any penalty fees be reasonable and proportional to the activity that generates the penalty and also on a key provision that credit card issuers, after there has been any rate increase other than just a macro rate increase, that they look at those increases at least once every six months and see if the rate should be reduced.

I would like to call on, at this time, Kathleen Engel to lead our discussion of that. Kathleen?

MS. ENGEL: Thank you, Mike. We certainly had great discussions, as we always do, about the Card Act. As Mike said, the Fed is in the third stage of rulemaking and has done a great job the first two rounds and the third round looks equally valuable.

So we had a presentation by Ben Olson and Amy Henderson and they asked the CAC to look at two issues, in particular, in this third stage of rulemaking. One was the proposed rules on penalty fees and the other was the proposed rule related to rate increases.

I'm going to, at this time, ask Andy, my -- I was going to say, partner in crime, but that's not good to say in federal buildings -- the vice chair of the Consumer Credit Committee, to start off the discussion because I know he has important things to say. And then he is going to lead the discussion from here after he speaks.

MR. NAVARRETE: Thank you, Kathleen. I joked earlier that since most of the issues that I am primarily focused on are front-loaded, I spoke a lot in the morning and perhaps a little less in the afternoon, and so I think that pattern may hold today.

I wanted to talk a little bit about the two pieces of the proposed rules. As Kathleen noted, first, the reasonable and proportional fees language and then, second, the rate reduction provisions. We will have some, perhaps, slightly more brief comments.

But we want to continue to applaud the Fed for its efforts in terms of drafting these rules. It has been an incredibly complex process and the efforts today, I think, have been quite admirable in terms of the level of creativity and thoughtfulness that has gone into each of the proposals.

I joked again yesterday that we perhaps have a slightly deeper set of concerns around these particular provisions than we have had with prior rules, and I think that perhaps reflects the subjective nature of some of the requirements and some of the challenges in the source material with respect to coming up with the right answer in this instance.

One of the great themes of the Card Act and of the Fed rules that preceded them, as well as the Fed rules that are being implemented now, is this shift in the cost of credit away from back-end terms, like penalty pricing and penalty fees, towards front-end underwriting and front-end terms like the headline APRs and annual membership fees and other more transparent terms. And we have generally applauded that trend. We do think that that is the right way for credit to be priced in the future.

This effort, I think, continues that trend, but we would caution that perhaps it tips the balance a little too much in favor of front-end terms and limits back-end terms that can more carefully target risky behavior than perhaps is prudent at this stage.

Our primary concern there is -- I'll take it in pieces -- first is, the omission of credit losses from the cost component. I think, as folks know, there are three components. There is cost, deterrence, and then a safe harbor that the Fed could adopt. The proposed rule explicitly excludes credit losses from the assessment of cost for issuers, and we struggled to understand why one of the principal elements of risk or whatever that we are trying to mitigate is excluded from that equation.

There is a citation to a footnote of an Argus study that, interestingly enough, the industry itself provided that shows that only 7 percent of people who pay late ultimately charge off. Again, on the surface, that may sound like a relatively small number, but I think anybody who tracks charge-off numbers in the industry knows it's actually an astronomical number.

During good economic times, you can expect an average of 4 percent to 5 percent charge-off rates in the industry, and the industry can be profitable under those conditions. When you get to 7 percent, you are getting almost to a break-even standpoint. And when you are getting to the 10 percent charge-off rates across the industry that we are seeing today, as folks know, the industry is, as a whole, demonstrably unprofitable at this point, losing upwards of $5 to $6 billion across the industry last year.

And so, at this point, the combination of APRs and fees are not sufficient, obviously, in an unprofitable environment to cover the cost of risky behavior and of credit losses. So we would urge the Board to reconsider whether or not credit losses ought to be included. We have reconvened the industry group that provided data the last time around to provide data this time around, and so that will be part of the formal comment process.

Second, there are citations in the proposed rule to the U.K. example. The U.K. went through a similar exercise a few years back and ultimately settled on a hard cap for penalty fees. Again, I think if we look more closely at the U.K. experience, we will see that it is a bit of an apples-to-oranges comparison. I say that because what the U.K. did was to say that because issuers have so much flexibility to reprice interest rates, there ought to be more strict restrictions on fees. The restrictions that exist on repricing in the U.K. are actually quite a bit more liberal than what exist here today post-Card Act.

What the Card Act is doing, obviously, with the repricing provisions that we have seen already implemented as of February of this year, you are restricting both the ability to adjust APRs for risk and now the ability to adjust fees or price fees for risk. It is a bit of a double hit to the industry. And so, again, comparing on an isolated basis, looking at fees to the U.K. experience, may not necessarily be valid from a pure comparison perspective. We would urge staff to really closely study that experience and that report in coming up with its final rules.

More tactically, and this is the last point I will make on the fee provisions and then talk briefly about what we call the unrepricing revisions, more tactically the way the tests or the options for the industry have been constructed feel a bit siloed from our perspective. There is a choice of either pursuing a cost path, a deterrent path or a safe harbor path.

Our reading of the statute has each of those blended in a way that perhaps allows for bits and pieces of each to be taken together to ultimately come up with the right price point for penalty fees. We do think that the way the rules have been crafted perhaps look at each one of those as strictly individual considerations that don't really blend or interact. The statute uses the word "and" not "or," not to get too geeky about the details. But again, we would urge perhaps a more holistic view of how each one of these factors work together in determining ultimately how to assess an appropriate safe harbor and how to construct the various tests under the cost and deterrence factors.

On the rate reduction provisions, there are generally very positive views on this. Again, it is very reflective of the historical way that the Fed staff have pursued this and we're very complimentary of the principles-based rules that adhere very closely to the statute and seem to hit upon the right ideas in terms of how to manage this on a go-forward basis.

I would particularly applaud the recognition that a lot of the price changes that took place in 2009 in advance of the Card Act, and in some cases much earlier in response to the original Fed UDAP rules, are structural changes in pricing. Again, consistent with this theme that the cost of credit now ought to be in more up-front, transparent terms rather than in back-end terms, that necessarily means that pricing as a whole will go up for a broader group of people. The repricings that took place in 2009 are reflective of that trend.

Recognizing that some of those changes are structural in nature and therefore -- I hesitate to use the word "permanent," because there are a lot of competitive factors that will drive rates up and down in the future -- but those are fundamental shifts that aren't just temporary responses to, for example, economic conditions or other exogenous factors, and so the Fed's explicit recognition of that in the preamble is very welcome.

The one area of question that the staff asked about yesterday is whether or not there ought to be a statute of limitations or a cap of time on the review process. For example, review rates every six months for up to, say, five years or some period of time. We agree that that ought to take place at some point. We ought to perhaps cut off the obligation to review for operational, compliance, and other reasons. We would probably advocate for something less than five years, and we'll certainly offer specific comments during the formal process for that.

I appreciate the indulgence on the long comments, but I will turn it back to Kathleen to make the other excellent comments that we have received from other members of the committee.

MS. ENGEL: Is there anybody who wants to respond directly to some of Andy's comments? Mike, can you talk a little bit about some of your concerns about how industry has responded to the Card Act?

MR. CALHOUN: I think a theme that came out yesterday, somewhat surprisingly, on credit cards and a variety of topics was that there was a lot of agreement that responsible regulation could move both industry and consumers to a better place. A big part of that was having clear rules.

For example, in credit cards, while the industry understood that the business model was to price everybody low, compete on teaser rates, have hair-trigger increases and more fee income to balance that off, consumers didn't understand that at all. It was a very complex market, very difficult for consumers to shop, and so it was hard for competition to work. Rather, this way, if fees and costs are front-loaded, it is a much more transparent shopping and competitive market. People can look and say how much is this costing? I can look at it up front and not try and guess how many fees I will get pulled into on the back side.

Just a couple of points real quickly and then I'll allow others to jump in.

We would note also that both the Act and the rules did allow considerable latitude still for companies in other areas -- the two biggest being credit limits and minimum payments, where the company still has a lot of discretion to both reduce credit limits if they believe there is an increase in risk and increase minimum payments, which we have fears, in fact, that there is too much latitude. For example, if someone goes from a 2 percent minimum payment to a 5 percent minimum payment, a lot of families can't absorb that kind of monthly payment shock, and that's going to trigger a whole series of events. Suddenly that person will be 60 days delinquent, and at that point you lose a lot of your protections under the Act. So that's an area that we think needs at least monitoring.

One concern and then just one general theme again -- one of the requirements is that there be this look back after six months to see should there be a rate reduction after there has been a rate increase? A gap in the protection right now is, even if there is a determination that there should be a rate reduction, there is no standard for how much that reduction would be. It could be de minimis and still be in compliance with the Act.

Again, I would return to the theme that this is a market, like so many, where simplicity helps consumers. And I think it helps issuers because they can compete on terms, not on who offers a teaser rate that you don't really have to honor, because you can't afford to give people 12 months of zero interest money.

It works better for both sides, but that does require this transparency and simplicity. We have some concerns that some of the proposals on the penalty fees get very complex. Penalty fees are already a hard area for people to shop on, and then if they are complex on top of that, it makes it almost impossible, we believe, for people to shop and have competition be a factor in the market.

MS. KEEFE: Could I just add to the simplicity piece? I agree with Mike. I was very excited about the Credit Card Act, and there were many reasons for it. From my point of view, also, it was to add simplicity and more transparency for consumers to be able to judge not only what their individual credit card was charging them and understand those terms and penalties, but also so they could potentially shop around and see whether or not they wanted to change credit cards, or if they were shopping for a new credit card, they could evaluate fees on credit card A to fees on credit card B.

Yesterday, I expressed my opinion that I think it would be great if the Board could set the limits. When I was just reading the materials, I felt like, oh, this was written by lawyers, made for lawyers and who can understand this. Then I got to the safe harbor provisions, and I was like, oh, okay, real numbers. I understand it's not as easy as just one-size-fits-all with fees, that lenders differ and the violations differ. But I would love to see a number standard set by the Board.

I am not confident to give these general guidelines to the industry and let them all determine for themselves, because I am cynical if not paranoid that they will come up with very ingenious ways to sort of manipulate the fees and sort of hide it again from me and take away that transparency that you talked about, Andy. So I would love to see just a set standard, whether it is the safe harbor or something more extensive, but really set fees on what they can charge.

MR. CAREY: If I could jump in, a couple of observations. First of all, I agree with a lot of what has been said here. And Mike and I often agree on a lot of things. I think that the best way to really make the credit card market work effectively is to really have more transparency so that the marketplace can work effectively. It is penetrable, so people can understand, they can make informed choices. Consumers will also have the ability to do that. I think a lot of work that the Fed has been doing over the last couple of years, particularly around Reg Z and the work product that is coming out with that, that we are actually going to see in the marketplace in August -- I think it's going to be a transformational event around the transparency of the marketplace. It will be interesting to see, because I think it is going to drive even greater competition and even greater sensitivity by consumers about certain practices.

To that end, let me take the look-back provision. The look-back provision generally is related to basically prospective pricing of future loans. For all intents and purposes, the ability to reprice existing balances is gone as a result of the Card Act. There is a limited exception. If someone is 60 days late, you've got to pile on notice and by the time that gets done, someone is so far into delinquency that you query whether it would be a good risk management tool to, basically, price somebody up according to their risk at that point, because you would risk tipping them over.

For all intents and purposes, the rate is what the rate is on the loans that you have taken. The repricing now relates to future balances. Again, a lot of transparency in this about how this information is going to be conveyed to consumers. Most of it we haven't quite seen yet because of the August rule changes, but things like 45 days notice, giving consumers the opportunity to find someplace else to go. Places where this information is going to be available, at Fed websites, the obligation for the institutions to post their card agreements. Again, this whole thing around transparency actually will drive competition.

So if you are an issuer and if you are interested in growing your business, if you miss the mark on your pricing, you risk losing market share. It's going to have to be sort of a very, very, very delicate balance. Again, I think the marketplace is going to drive a lot of the competition.

If I, as an issuer, have mispriced it and I have taken a customer who has been good and I move them to a rate that is too high and isn't consistent with the marketplace, I know my competitor is going to be able to pick them up because of what's happening in the transparency of the marketplace. So as you think about these look-back provisions, let's understand what the effects of the marketplace would be. I think it is an important thing to look at.

Getting to the penalty fees and the late fees, I get the simplicity argument. But again, issuers are going to have to post them. They are going to have to present this information the same way and literally see how those things are lined up. Now, I get the fact that a lot of people don't think that they are ever going to be late, they are always going to be on time, but the idea around providing the information to the consumer is going to be clear and transparent.

What is not going to be clear and transparent is how that number was derived. I get that, and that's an issue that we have to wrestle with. But let's not confuse what is going to be transparent to the consumer and how the numbers are derived. Those are two different issues. I would caution around the notion of having bank regulatory authorities setting price points. I think that is new territory, at least in my limited experience.

One of the things that I talked about yesterday was there are some lessons that we could learn, and again we could do this around transparency so consumers could see this. We see it all the time in our utility bills. Pay your utility bill by the 15th of March and if you do that, it costs you $100. If you don't do it, on the 16th it costs you $120. If you lay that out – you say, your minimum payment is this and if you don't make the minimum payment by this date, then it is going to be this -- that is very transparent to the consumer. They are not surprised by the so-called hidden fees and all this other stuff, but you create this really transparent place where consumers go ah, I get it. I get what I have to do and I can do that.

We were talking and I've read a lot of stuff about how issuers are kind of going here and they are doing this. When we think about regulation for credit cards, I think we've always got to figure out how can we shine the harsh light of day on all of the practices that people find to be not consumer-friendly. If we can do that, that's going to drive the kind of reform that all of us in this room want to see.

MR. PHILLIPS: We do a lot of business lending in my organization in Maine and do a lot of business counseling too. We know that there is a build-up of the use of credit cards for business purposes. There is a study currently going on now by you to look at those questions and how some of the consumer issues might apply from the Card Act for business use of credit cards.

So that's a conversation coming in the future here, I believe. I raise it because, from my point of view and experience as a consumer and also working with a lot of individuals and families as others here do, the credit card market is a huge market and use of capital in this country. I think there is something like 1.2 trillion credit cards circulating out there. Is that right?

MR. NAVARRETE: No, probably about half that.

MR. PHILLIPS: I mean, 1.2 billion excuse me.

MR. NAVARRETE: Actually, it is probably somewhere in the neighborhood of 600 to 700 million cards.

MR. PHILLIPS: And then retail, you add retail to that?

MR. NAVARRETE: Yes, yes. I think you're looking at it from an outstandings rather than an accounts perspective.

MR. PHILLIPS: Well, there goes my first statistic. I'm trying to get to my point here, I guess, to recommend to the Board of Governors that the credit card, which I have and all of us have, and we don't want to see them disappear, is essentially a loan. I know personally when I use a credit card as a consumer, I'm mentally at least calculating how that is going to get paid, whatever the price, so I'm not going to get in over my head. I know my wife won't let us get in over our heads.

But we are probably exceptions. There are a lot more consumers and families that have gone much deeper into this loan and debt, not understanding what the debt relationship is.

The Card Act is taking the business model of the credit card companies – I think there are, what, 10 large companies that account for most of the credit card market here in this country. The Credit Card Act is shifting that business model, which I think is a good thing, and there have been a lot of necessary actions by the credit card industry to shift their model and their pricing and how they price risk and how they are going to maintain some kind of revenue model for it.

But one of the most fundamental things about debt when you take out a loan is somebody is underwriting you to issue that loan, the credit union or the bank. We've all had some experiences with that -- so mitigating the risk right at that point of issuing the card.

So the question is, going forward in terms of all of the pricing, what is that initial issuance like? What is the risk? How is that individual and family being underwritten? What are the restrictions to that underwriting? I think that is the shift going on now and should be encouraged – that, before cards are issued, more oversight and underwriting in the conventional sense of the way banks and credit unions have done things in the past ought to be done.

And so I am just sharing that perspective for you as we go forward in this.

MS. RAND: Good morning. I have a concern regarding an aspect of the proposal where the credit card issuers that base their penalty fees on deterrence must use "empirically derived, demonstrably and statistically sound models that reasonably estimate the effect of the fee amount on the frequency of violations." I have to say that when I read that, my first thought was, is this the same standard that was used to look at the algorithms that were used for mortgage risk? If so, that would be really scary.

I was told at the meeting yesterday that this is not the same standard. But I would encourage you to very closely look at these statistical models and make sure that they really are doing what they are supposed to do under the proposal.

And I thank you for the increased transparency and consumer protection aspects of the rules that you have written.

MS. ENGEL: I'm going to make a brief comment and then Andy is going to run the show for the rest of the time.

I just wanted to highlight that, in the memo from the Board, which, as always, is really fabulous, they describe what the Card Act actually requires. It says that the Board is supposed to consider the costs incurred by the issuer -- this is all in terms of the penalty provisions -- the deterrence of violations, conduct of the cardholder, and other factors. And then the last line in the section says, "Finally, the Act authorizes the Board to specify an amount for any penalty fee that is presumed to be reasonable and proportional to the violation." That language suggests to me that Congress was thinking that a precise number for the penalty fee or the late fee would come out of these rules. So I think it is not out of line to consider that approach.

The second thing related to the penalty rules is that the standards under both deterrence and the cost loss, a standard for determining the size of the penalty, both require a calculation by industry or by the issuers to determine what the cost is of a violation in one case and in the other case the cost or the level of deterrence needed to keep people paying on time.

I am reluctant to defer to the private sector to set the rules for the public. I mean, the Fed isn't public in the same way as some other institutions are, but it is a public entity that is writing rules pursuant to a request or demand by Congress and to defer some of that rulemaking, in a sense, to the private sector, I think, is highly problematic.

The third point is that I really like John's idea about the utility bills, because with the utility bills there is that clear sense, if you pay this amount now, you are not going to have to pay a penalty. And if you don't, this is what you are going to have to pay if you pay after a certain date. That's great.

The other thing I would add to it, though, is that utility companies have set fees if you are late, so that's a nice model to look at. The utility companies, it seems to be working for them. I assume that those standards were set by some public body based on information gathering in determining what was a reasonable late fee.

MR. NAVARRETE: A couple of responses perhaps to the last three comments. I'll start with Kathleen’s. I would draw a semantic distinction between rulemaking and price-setting. I think our concern here is the notion that this is somehow being ceded to the private sector. It should be. Pricing for a private-sector industry ought to be set by the industry itself. It is taking quite a leap to suggest that government ought to be setting pricing within a private-sector industry. I'm not sure where else that precedent exists in a significant way. And I'll stay out of the health care debate for the moment.

But that would be certainly a concern of ours -- achieving the appropriate balance. It's appropriate for the Federal Reserve to write rules suggesting how certain calculations ought to be considered and what factors ought to be considered. I mean, that's done all the time. Fair lending is perhaps the most salient example of that where, obviously, there are any number of risk factors, as we discussed yesterday, that could be relevant. But many of those risk factors are impermissible from a fair lending perspective, and so the industry and regulators work together to make sure that we strike the right balance.

I think the same principles ought to apply to this debate, but it ought to fall short of saying this is the price and it should be for all time. I would also not necessarily equate the banking industry, at least in its present state, to a public utility. Again, it is a very different set of business dynamics.

To Dory's point about standards, I think you are right, what we talked about yesterday is that the standard for deterrence appears to be drawn from Regulation B -- again, from the fair lending standard. But I would observe that I think the standard is actually quite a bit narrower in this context than it is in the Reg B context. Reg B says that it ought to be demonstrably derived and statistically sound, and all of those, of course, are principles we applaud.

I think the difference between what is being proposed here on deterrence and what is in fair lending is the inability of issuers to use any data outside of their own experience. There is no ability to go out and look at other industries, like utilities, to look at other issuers or other experience and to draw that in. That seems to be a constraint. That feels a bit arbitrary to us, and we are not sure what policy objective is being achieved. It is certainly not something that we think is required within the statute.

The last point I'll make gets to Kirsten’s and Ron's points about simplicity and consistency and ease. The standards for determining cost and then the standards for determining deterrence are quite onerous and quite restrictive, at least in terms of how they are currently drafted. I will say that that probably favors larger institutions against small. The reason I say that is because we have perhaps ample resources at Capital One -- and I look at John and Kevin and they probably have ample resources at their institutions -- to make a choice here between saying we're going to look at the cost component and try to derive a cost number that we feel is legitimate or to look at the deterrence factors.

I have a hard time imagining, as I look to Alan, that a credit union with a smaller portfolio and a much thinner staff would be able to say, wow, let's come up with statistically derived, all of these complex equations to arrive at a different answer. For those smaller institutions in particular, a reasonable safe harbor is going to be extraordinarily important. So I would urge the Fed to consider in determining that number -- and it is clear from the rule that you intend to provide a hard number for that safe harbor -- to make sure that it is a reasonable number, because I think for a lot of institutions, it's going to be the only option.

MR. CAMERON: I agree.

MR. WISEMAN: Good morning. I don't see this as the Fed deciding to write regs that have to do with pricing and to have an overbearing influence on how that happens. This looks to me like a debate about fairness and what is fair and what is overreaching on the part of certain players, certainly not the gentlemen who are here. I think most consumers, the overwhelming majority of consumers have little to no meaningful choice about what credit card they use, what their credit limit is, and what they have to use it for.

We had a discussion at breakfast about how so many people in this country, their first mortgage is in default, but their credit card is current. I have a sneaking suspicion that most people know that they can find another place to live, but they cannot find a way to get things done if they don't have a credit card.

So if the decisions that the Board makes about a particular regulation and whether or not something is fair affects a pricing decision that a credit card company makes, I believe that's something that the marketplace will dictate. I also believe that's sort of a cost of doing business. There are people who make a lot more money than me who have a lot more education than me who spend their whole lives deciding how to price particular types of credit and how to put those limits on. So I don't think the industry will be so flat-footed.

In terms of deterrence and the different fees, I agree with Dory's point. I don't think that a study can be done to effectively show what kind of fee is deterrent to somebody. I think people who default on their credit cards do so because of life circumstances. I don't think it's really a choice. It would seem to me reasonable for the Board to decide what the cost is of a particular default or infraction and levy that as the cost of a late fee or the cost of different types of fees.

It seems to me that the ultimate type of transparency is for a different list of fees to come out, have them be reasonably tied to the infraction. That seems to make the most sense to me. I would also recommend that the Board undertake their own study of anything that is left to industry to do. Especially if the deterrence language is left in, I see no reason why the Board cannot decide on their own what types of fee or deterrent or whatever else is put in the reg for the industry to figure out. Thank you.

MR. NAVARRETE: Kevin?

MR. RHEIN: A couple of comments. If I understand the reg, the way this is going to work is if an issuer goes through and tries to use a calculation on cost or if they use a calculation based on deterrence, that is obviously stuff that is modeled, and I'm assuming that would be subject to audit by a regulator. So I would like to try to disband the notion that we are going to go behind our closed doors, we are going to come up with these wonderful calculations and that there is no inspection of that. I think that would be a primary element that the regulators would take a look at and say, show me how you got to this analysis. Regulators are really smart people. They have got their own statisticians and they will, I think, challenge if we don't have the right kind of model.

This independence -- just know there are people that will be looking over our shoulders and trying to say, show me, prove it, I want to understand this better. It happens all the time on all sorts of things we do.

The second thing is I just want to point out something Andy said about what is happening in the industry -- $5 billion industrywide losses last year. Most credit card companies won't make any money this year. If you start to think about strictly a cost-recovery component of some of these fees, to John's point earlier, a lot of the ability to manage risk, to be able to price for that, we have lost a lot of those tools. So fee-component income is an important driver of the income statement of the company.

If we keep taking away and taking away and taking away, what is going to end up happening is there will just be a whole lot less credit available. If that's the desired outcome, we're going to get there. There is just going to be a lot of companies that are just going to get out of the business.

I think we have to really balance where we are in the economy. Credit is a life blood, to Ron's point. There are many businesses that get started right, wrong or in between based on their personal credit. We are making massive changes, none of which have had a chance to make it through the system yet. As you continue to pile on and pile on and pile on, nobody likes to hear about unintended consequences, but it is the reality of what happens. And there is no testing control going on here.

So I would just encourage the Fed to be moderate where possible. You can always come back and take another bite at the apple once we see what this first wave of changes started to do. Thank you.

MR. NAVARRETE: Lorenzo?

MR. LITTLES: I think that the issues of fairness and simplicity and transparency are the concepts that we ought to be focusing on. I'm in my third year, and I haven't spoken a great deal. Housing is my specialty, so I'm a little bit out of my depth in dealing with credit.

But it seems to me that a lot of the discussion ends up being around whether in a particular year the credit card companies, the issuers are doing well or they are not doing well. It also seems to me that the imposition of the reg and the Act was to move us in the direction of fairness and to protecting the consumer, who doesn't have the same bargaining position, if you will.

I don't think that most people abuse their credit cards because they want to. I think that -- and this came up yesterday -- I think it was Patricia who said that, in the mortgage industry, 92 percent of people are paying on time. So even though we are spending a lot of time focusing on the 8 percent and the tragedy of the 8 percent, from the business standpoint, the banks and the lenders are focused on not making changes that would annoy or adversely affect the 92 percent.

I think that a lot of the discussion here is inappropriately focused on the temporary situation in which the issuers may be experiencing some losses. A lot of the conversation that I have heard during my tenure here is that we should push back on individuals to be responsible. And I completely concur with that.

But in a free enterprise system, you can go into business. You can take the risk. I think it was Ron that just said that, if we are talking about unsecured loans, you have made the decision to issue these cards to people and you want them to use them. And then when they use them, but can't fulfill all their obligations, then you want protection against the decision you made. That doesn't make sense to me, that doesn't seem reasonable to me. If you have made the bad underwriting choice in the outset, then you ought to suffer the unintended consequences.

MS. ENGEL: I just have a couple of quick points. One is that I'm not saying this to sound sarcastic in any way. I have actually been really impressed with the credit card industry's ability to make changes quickly and, it appears, seamlessly in response to the upcoming Card Act or the implementation of the Card Act regulations. I appreciate that it's a really big deal when new regs come out and how you have to gear up new IT systems and develop new models.

So the experience of the last year doesn't make me too worried about the operational challenges, because you all have done a really good job. There are going to be new regs no matter what. So it's not a question of regulation or no regulation. This is the third stage of the regulation, and Congress has told the Fed they have to do it.

The second point is that I don't see the discussion about having a set penalty fee as being a conversation about taking fees away from issuers. That's not what it is about. Everybody agrees that issuers should be entitled to collect penalty fees when borrowers don't make their minimum payments or are late. That's not the question.

The question is, should that figure be based on internal modeling by the private sector or should it be a fee that is set by the Fed? That's really the question. Of course, any fee that the Fed would set would be based on information they would gather from industry. That's part of the reason we are here, why there is a comment period.

The third thing is that this is not a situation where we, people on the CAC are saying that the Fed should step in here and assume the responsibility for making pricing decisions that best lie with the issuers. What has happened here is that Congress gave the Fed the authority to determine what the penalty fees should be. At least two of the provisions in the proposed rule essentially defer that determination about penalty fees to the private sector, so I think that that is a problem.

Other reasons to think hard about a set fee -- one is that it does level the playing field for banks. It means that the credit unions aren't going to have to go with the safe harbor and Wells and Capital One can decide their own fee based on the fact that they have these fancy quants who can figure out a model. It would make it more even of a playing field for all of the banks.

The last point goes to something that we have been talking around a lot already today and a lot yesterday, which is the whole point of putting as much as possible in the front end, so that borrowers can shop, so they can engage in meaningful shopping. If it's a set late fee that every borrower has to pay on every credit card account, then when they go out to shop, they are not going to be -- and I don't think most people look at the fees, penalty fees, but to the extent they do -- they are going to go out and they are going to be shopping on interest rate, which is really what we want them to be doing, and maximum loan amount and things like that.

But it will really reduce the number of pieces of the puzzle that consumers have to consider in making credit decisions. We all agree that when consumers make informed credit decisions, everyone wins.

MR. CAREY: Kathleen, could I jump in? Is that all right? Who do I ask?

MR. NAVARRETE: John, then we will go to Corey after that.

MR. CAREY: A lot of great points, Kathleen. I think, to your first one about the operational challenges and the ability to kind of make the changes that the industry has had to make in order to comply with the Card Act and that accelerated time period, the way we have talked about it at our business is it's as big as Y2K was in the amount of effort and time that it was. We literally devoted an incredible amount of resources that, rather than going to innovation, was really going to compliance stuff.

But I think we are sort of confusing that the issue with that is we're not really talking about operational challenges. Really what we are talking about, and I think this goes to Lorenzo's point, is the sustainability of the business model. It's really, ultimately the issue. At some point in time, companies are going to have to make some decisions about what is the appropriate return on investment, return on capital that you make, given the risk parameters to it. If you can't meet that hurdle, then you've got to find a way to get there. You turn a lot of levers.

In our businesses at Citi, we made a decision that we were going to exit – it's a terrific business -- but we are going to exit the private label space over time and find a buyer for it or spin it off or whatever the business guys ultimately decide to do. Part of that is just because it's not going to meet the hurdle.

When you change the accounting rules, you change the ability to price for risk, you have an extraordinary credit event, you can't, at the end of the day, after you have written off -- let's say it's a $100 billion credit card portfolio -- after you have written off $9 billion, hand your company an additional bill of a billion dollars to basically have the pleasure of running a business.

So we've got to figure out a way. We've got to figure out a way that makes the business model sustainable. I think we are missing the point around this profitability. It's not just one year. But do we have line of sight to how credit cards can provide an appropriate return, given the risk, to those companies that decide that they want to stay in that business? And that, I think, is the question that all of us need to sort of wrestle with. Otherwise the only people that are going to be harmed from this are consumers who won't have the same access to the things that they want.

I don't think anybody here is saying that penalty fees are being taken away. I just think, again, what we are trying to say is let's make sure that we capture a lot of the costs that come from, for example, when people are late. The data that is in the report, I don't know whether it is right or not, but it's saying 7 percent of all customers who are late when a fee is assessed actually roll to charge-off.

Well, why aren't we capturing that cost? That's a real related cost. Yet it was categorically excluded in the draft regs. If we really, really want to look at what the real cost is when somebody goes a day late, I don't know how you can just sort of carve out those pieces. We are just asking that all those factors be considered when we come up with what is an appropriate measurement, for example, penalty fee, when people are late.

MR. NAVARRETE: Corey?

MR. STONE: Thanks. I find that I'm grateful for the legislation's attempt to try and balance both transparency and simplicity with fairness. I think it really is trying to be fair to both the industry and to consumers. In particular, to allow the industry to recover costs and to manage its costs through deterrence, the way it allows for those calculations to be brought.

At the same time, I think that those two goals may be in conflict in the way some of the options have been presented for determining costs or determining deterrence. If you looked at deterrence, for example, what is going to keep people from paying late? I can tell you about a household that I know very well where we are transactors, we are non-revolvers on credit card accounts, and we pay late twice a year depending on who is responsible for paying the bill that month. The other spouse, believe me, is outraged at the payer's incursion of financing fees that, as a result of our last year's late payment on John's card, are now 29.9 percent. Not reflective of our credit scores, I think, but just the way the math tumbled. That by itself without any late fee is plenty of deterrence for the payer's spouse to make sure that he or she is on time next month.

That's a segment of the market that might be very different from somebody who is always bumping up against the edge and might need some kind of deterrence. My point is, I think it would be very difficult to come up with a model that really captures correctly the variation in what really motivates consumers and describe a deterrent that really accurately reflects any one group's behavior.

You could really say the same thing about costs and including the costs of non-payment. If I understand the statistic correctly, if only 7 percent of late payers roll to charge-off and the other percent, of which either I or my spouse are in that group, do not roll to charge-off, there is a large group that arguably should not bear the costs of collections, because there is no cost of collections when the check has arrived a couple days late.

It does create a great deal of profitability that, I think, is part of what pays for our frequent flyer miles.

I think the staff's effort to try and add sophistication through such things as escalation of late fees over multiple days, which makes it more and more reflective of costs, adds complexity, takes away from transparency. I think that, at this point in history, the burden on us as a country, on the industry, on those of us who are consumer advocates, is really first and foremost to bring back trust and simplicity to a product that for a variety of reasons has been the source of a great deal of suspicion and ill will.

At the end of the day, I end up finding myself very sympathetic to what Kathleen said. I would love to see firm prices. I would love to see them set in dialogue with the industry. I hope that the current loss position of the industry is one that will reverse itself and where, at some steady state, there would be some stability in those fees.

But I think the overall benefit in having something that everybody can understand when they look at their statement, regardless of how or whether it does or doesn't level the playing field within the industry, if it restores consumer trust and makes it easier for people to make decisions and understand what it is they are doing when they pay for a tank of gas, that's the overwhelming benefit of moving forward in that way.

MR. NAVARRETE: Governor, did you have a question?

GOVERNOR TARULLO: Yes, I do. Thank you. Actually, I have several questions for several of you, all of which begin from the same point, which is trying to understand the statute. Somebody said earlier we're not writing on a blank slate anymore. I mean, it's the Congress that has made decisions about what should happen with credit cards. It's not us under a very broad standard.

So regardless of whether the faithful implementation of this would help or hurt the credit card industry, we've got to do it, and we've got to do it with our best reading of the statute. It absolutely is the case that we're just like any -- there is no difference from us and any other agency in this respect, because this is a Board function. It's not an FOMC function. We are just operating as the SEC would operate in doing its rules.

With that in mind, several of you have said things that either implicitly or explicitly referred to the statute, and I just want to understand a little bit better what the arguments were.

Maybe, Andy, I could start with you. You were suggesting that the exclusion of the taking into account costs that will eventually result from defaults of those who are late is inconsistent with the statute?

MR. NAVARRETE: Yes. The way it is written is the Board shall consider, so that's sort of the mandate piece of it, the costs, deterrence and other factors.

GOVERNOR TARULLO: Yes.

MR. NAVARRETE: We certainly believe that, somewhere between cost and other factors, credit losses should be included in that. The exclusion of it feels like it is -- I mean, it feels like there is plenty of room within the statute to consider those factors.

GOVERNOR TARULLO: Can I ask you about that?

MR. NAVARRETE: Yes.

GOVERNOR TARULLO: [Section 149] subsection (c)(1) says, the cost incurred by the creditor from such omission or violation.

MR. NAVARRETE: Yes.

GOVERNOR TARULLO: And that omission or violation would be the failure to make the payment on time, not from the eventual failure to default, wouldn't it?

MR. NAVARRETE: I think within the framework of the statute, you can either read it narrowly or read it broadly. I don't think there is any restriction on reading it more broadly to include costs. Part of this is that I think the statute is written in a way that leaves, again, plenty of room to consider a broader range of costs. I think the Board has chosen to read it narrowly.

GOVERNOR TARULLO: Well, I don't know about chose. I mean, again, what I understand to be our responsibilities in accordance with appellate court decisions on how to read statutes is to try to read the language with the natural meaning --

MR. NAVARRETE: Yes.

GOVERNOR TARULLO: -- as the words normally convey, unless they are terms of art, which are specifically defined. If it's a cost incurred from the violation, which is to say the failure to pay, that's not, is it, the eventual cost of default? I think you said that 93 percent of the people who are late will eventually pay and won't default.

MR. NAVARRETE: Right. And I was planning on responding to Corey's point on this -- and thank you, Corey, for not charging off even after a late payment -- because the fact is --

MR. STONE: John should thank me.

MR. NAVARRETE: But part of this is just the odd economics of how the industry works. Again, when we are talking about 5 percent versus 7 percent versus 10 percent, these are enormous numbers when you are talking about lending. It only takes one default to wipe out the profits represented by 10 borrowers.

So I guess, Governor Tarullo, I would answer your question this way, which is 93 percent of -- and it's actually more like 90 percent today, by the way -- but 90 percent of borrowers who pay late will eventually not charge-off. But 100 percent of credit losses come from people who pay late.

GOVERNOR TARULLO: Well, that's by definition, right?

MR. NAVARRETE: Yes.

GOVERNOR TARULLO: Right.

MR. NAVARRETE: Yes. So I mean, there might be some --

GOVERNOR TARULLO: One hundred percent of credit losses come from people who have credit cards.

MR. NAVARRETE: But what I can show you that's statistically meaningful, that 100 percent of credit losses comes -- so when you are looking at splitting risk and determining what behaviors are risky and therefore we ought to be compensated for those risks, late payment is the single greatest indicator of the likelihood of charge-off.

For the people who never pay late at all, they will represent virtually zero percent. I mean, there may be some odd people who pay on time and then go bankrupt and sort of wipe it out immediately. But that's an extraordinarily small number.

GOVERNOR TARULLO: I understand the argument you're making.

MR. CAREY: Governor?

GOVERNOR TARULLO: And again, the point is that we have got to read the statute, not create our own economic analysis of kind of what makes sense.

MR. CAREY: Could I just try, because I think if you look at the statute and you took that narrow definition, as I think you have described it --

GOVERNOR TARULLO: Could I stop you there? When you say narrow, how is it narrow?

MR. CAREY: Well, if you take the language that you have there and you apply it literally, then there must be an account-level-by-account-level analysis about what the actual costs are for that particular consumer. For a business that has got 21 million active customers at any given time, it's not a reasonable thing that we can do. So you have to add some level of reason to it.

On the penalty-fees side, if 7 percent of the customers that actually go late ultimately roll to charge-off, the argument that I'm saying is, fine, then you take your total charge-off and you take 7 percent of that and that becomes part of the cost that you can consider.

GOVERNOR TARULLO: But all of that is irrelevant unless the language allows for that interpretation. I think you are right. I think a narrow reading of this would be from any particular failure to pay. A broader interpretation would be from failures, from late payments. I think that's what the Board is proposing here.

Can I move, Kathleen, to something you said? So did I understand you correctly to be saying that you think that the rules should be just straight fees, that we should just set what the fees are for everybody and that's what is a reasonable and proportional penalty fee in dollar terms and that's the end of the reg?

MS. ENGEL: Yes. I think that there may need to be some variation based on what the actual nature of the violation is.

GOVERNOR TARULLO: Right. So you pointed to some language, which was, provide an amount for the penalty fee or charge. But that's under a subsection that is entitled Safe Harbor Rule, a safe harbor rule being authorized. If that's all we did, that would kind of read out subsections (a) through (d), wouldn't it?

MS. ENGEL: I think it probably effectively would do that. The industry has said that the deterrence calculation would be pretty much impossible to figure out by the August deadline.

So I think that that's out.

So then really all it is, is either the cost or the safe harbor -- and the safe harbor. What I would argue is merge those together, work with the industry to calculate what the average costs are for the different types of violations. I think there are two major types of violations. And then you have a set dollar amount.

GOVERNOR TARULLO: So let's see, so you are basically saying that what is authorized in (e) should become mandatory?

MS. ENGEL: Yes, I don't have the full text of the law with me, just the summary.

GOVERNOR TARULLO: Yes.

MS. ENGEL: But I think it says --

GOVERNOR TARULLO: Here.

MS. ENGEL: -- to consider those factors. Yes. So the language is, “In issuing rules required by the section, the Board shall consider.”

GOVERNOR TARULLO: Yes, right.

MS. ENGEL: So it's not mandatory.

GOVERNOR TARULLO: That's right. No, no.

MR. NAVARRETE: No, no. I think the --

GOVERNOR TARULLO: It is mandatory to consider the factors.

MR. NAVARRETE: -- first section is mandatory.

MS. ENGEL: Right. But I mean, it's not mandatory -- right. So I think what you are saying is there should be a rule and then a safe harbor.

GOVERNOR TARULLO: Well, I'm just trying to figure out the statute. It looks as though the statute is structured to have mandatory consideration of factors in setting standards in [subsection] (c).

MR. NAVARRETE: Yes.

GOVERNOR TARULLO: [Subsection] (e) provides for a safe harbor, which may take those factors into account, but is basically saying, this is it. By definition, this amount satisfies the reasonable and proportional standard. And subsection (d), referring as it does to setting different standards for different set of violations, suggests that (a) through (c) are about setting standards, not setting amounts. That appears to be the way it is structured, but I'm always interested in any other interpretation.

MS. ENGEL: So I see that (a) through (c) are saying, look, these are the things that you, the Fed, should be taking into account in setting these rules. And that (d) then says and you can have different fees for different types of violations. And (e), I think, is confusing because the title is the Safe Harbor Rule Authorized, but then the language isn't safe harbor language.

Usually you think of safe harbor language as saying, if you choose these routes, you can choose these different avenues or you can go to the safe harbor where you are not going to have to do all this complex stuff to be able to set the fee.

GOVERNOR TARULLO: Right.

MS. ENGEL: The language under safe harbor says, the Board in consultation with all your different partners "may issue rules to provide an amount for any penalty fee or charge described under subsection (a) that is presumed to be reasonable and proportional." So it sounds more like a safe harbor for the Fed, right? It's saying to the Fed, you can make these rules, or if you want, here is the safe harbor you can just throw in a dollar amount.

GOVERNOR TARULLO: Oh, as opposed to it's -- we can enact something, which then Andy knows is going to be reasonable and proportional. He doesn't have to go through this big rigamarole.

MS. ENGEL: Right. But he is going to --

GOVERNOR TARULLO: That's his safe harbor.

MS. ENGEL: You're going to consult with him-- no.

MR. NAVARRETE: Well, yes. I think the use of the safe harbor here is a bit of a -- normally, it's the safe harbor from litigation risk or something else along those lines.

MS. ENGEL: Yes.

MR. NAVARRETE: There is no private right of action under this particular provision, so I'm not sure safe harbor is the right term. So I almost hesitate to get hung up on those semantics.

But I think you raised a great point, Governor, which is (a) through (c) are sort of mandated -- at least I read "shall" as a mandate. And so the Board shall consider these factors. With respect to credit losses, I would feel comfortable interpreting credit losses as a natural consequence of (c)(1) or as a potential factor under (c)(4), which is a catch-all.

The safe harbor, interestingly enough, is "may."

GOVERNOR TARULLO: "May," yes.

MR. NAVARRETE: So that's the optional piece of it. One of the things that we will comment on more specifically in our letter is that the rule as proposed right now sort of inverts, I think, the mandate a little bit. By making the cost analysis so restrictive and the deterrence analysis so burdensome, it actually makes each one of those potentially irrelevant and then overweights the optional piece, which is the safe harbor.

From purely statutory-construction perspective, I'm not sure that the proposal matches or aligns with the language.

GOVERNOR TARULLO: I don't want to rehash this, but I think it all turns on what the preposition “from” means and whether there are alternative formulations, which Congress could readily have used, such as “associated with” or something of the sort.

So let me go on. One other question. Dory, you evinced some uneasiness with modeling as a basis for deterrence. Is there some alternative to modeling, given that we do have to look at the statutory factor of deterrence?

MS. RAND: I'm not opposed to modeling per se, if it truly works. The way that the algorithms didn't work in the mortgage crisis is what gives me pause. So I think that if you, as the supervisors, can really understand the models that are used or provide adequate models, then I'm okay with that. I'm not a statistics expert, but I know enough about the algorithms to know that models don't always work.

GOVERNOR TARULLO: I got it, okay. Thank you.

MS. ENGEL: I have one more thing to add to this again, separate from Andy's discussion about losses, because I don't want to go back to that. I think that what the statute is saying is -- and the use of safe harbor here is really funny, in a way. Oh, so nice that they are giving the Fed a safe harbor, because that's really who they are talking about giving a safe harbor to in some ways, I think.

But it seems to me what Congress is saying is you need to enact these rules. They have to be reasonable. You need to take these different factors into account in assessing reasonableness. Essentially, you can come up with a standard or, if you want, you can come up with a dollar amount. That's how I read this. That's why I think it's a safe harbor for the Fed.

GOVERNOR TARULLO: So you read it that we could just say, it has got to be x dollars, and no company would have any ground for saying, wait a second, we can calculate what it actually costs us and what it actually costs to deter, which is substantially higher than the amount you have set?

MS. ENGEL: I don't think it is an ex-ante analysis. I mean, it's not ex-post. You want it to come -- that discussion needs to come at the beginning. If it happens to be that a particular issuer has higher costs associated with violations because they have more subprime borrowers, then they can reflect that in the interest rate.

But to have one set fee is certainly within the mandate from Congress. It says that specifically – "to provide an amount for any penalty fee or charge." Clearly Congress contemplated that that would be a route you would take.

GOVERNOR TARULLO: Could take.

MS. ENGEL: Yes, could take. I'm sorry.

GOVERNOR TARULLO: Okay. Thanks.

MR. NAVARRETE: Why don't we go with Mike. You know, we worried about whether or not we would fill the full time, and of course we did.

MS. ENGEL: Yes.

MR. DIAZ: So I should go ahead?

MR. CALHOUN: You can go, yes.

MR. DIAZ: My comment had to do with the issue of you setting a price on the average. A simple example -- I have one foot in a bucket of ice water, my other foot is in a bucket of hot coals. On the average, I'm feeling pretty good. When you are setting prices for the industry in that manner, you unfairly compensate folks who have a very efficient way of operating, and you unfairly penalize those folks who happen to have higher costs just because they are smaller in scale.

It's important that people can reflect that in a way that they approach the consumer. But to bind someone with those prices -- my ultimate concern is, is there going to be credit for everyone? When you do these things, you curtail the availability of credit. At the end of the day, what we need to function is credit. Thank you.

MR. NAVARRETE: Mike, why don't we give you the last word here?

MR. CALHOUN: Not necessarily the last. I just wanted to raise a couple of observations and a couple of questions about how you apply this. I think going back to the statutory interpretation, it is worthwhile to look at the very broad context of how this was enacted. That is, if you go back to before the Smiley decision, which authorized banks to set late fees regardless of any state law limitations on late fees, late fees exploded. But if you go back to the pre-Smiley era, late fees were a small fraction of what they are today and credit cards were still very widely available.

MR. RHEIN: That's not true.

MR. NAVARRETE: Not true, no. Mike, I just have to address that point, because in the pre-Smiley era, credit card penetration was about 25 percent. It is 75 percent today. It's just a complete apples-to-oranges.

MR. CALHOUN: There was also rate deregulation that came about --

MR. NAVARRETE: Yes, all of those factors combined to open up credit.

MR. CALHOUN: -- that was a huge part of it.

MR. NAVARRETE: Right. But we could go back to the 25-percent days.

MR. CALHOUN: There has been a race to the bottom, I think, on penalty fees. Clearly, the provision reflects a Congressional intent to change current practices on penalty fees. They didn't need the provision at all if Congress thought penalty fees were working okay prior to the enactment of the Card Act. I think that's a fair read.

It is meant to change the way penalty fees are here. So one test would be, if the result of this is you come out essentially authorizing penalty practices to continue, I would suggest that that's an interpretation that does not carry out the intent of the Act.

I just want to raise three particular, more individualized areas that I think raise questions of how you apply the broader standard. That's the broad picture. These are more deep dives in the weeds.

One is, I think, a particularly vulnerable area. We have talked about that you are going to get these notices in the Schumer box when you get your card. But the statute does not lock those fees in permanently. Penalty fees can be changed through the normal change-of-terms provisions. At that point, I think, it is a much less transparent situation. If we quizzed everybody here on what were the provisions in the change-of-terms letters they have gotten from their credit card companies, I think we would have a very hard time coming up with passing grades.

I would urge the Board to look at ways, particularly if it goes this route, of allowing the individualized penalty fee that every company can do its own analysis and argue that that's a permissible fee based on that individual analysis of that particular company's book of business -- or I don't even know if you can go to, you know, sub-book of business -- that if you go that route, given that you can change penalty fees through the change-of-terms provisions, I would urge that you put in some procedural safeguards there, such as that any analysis would have to be submitted to the Board for review if they are going to base a change of terms to raise penalty fees. But some protection there -- it's just a very vulnerable combination of change in terms and individualized penalty fee setting.

Another, somewhat technical issue is that there is more than one type of action that can trigger the fee. The two primary ones here that we are talking about are late payments, but also over-the-limit. The Board's proposal chooses to treat those the same, and I think there are questions about whether that is correct.

For example, over-the-limit, particularly if you are going to the deterrence, the cost analysis will likely produce, for most people, a much lower number, and the deterrence would add more room for discretion for a higher fee. On an over-the-limit fee, the deterrence is pretty easy. The company can stop the transaction. You don't need a lot of fee to deter over-the-limit transactions. And it seems to apply to a late payment, where the company does not have control over whether the act occurs -- to apply the same fee that you justified for late payment, to carry that over to the over-the-limit does not seem to be in keeping with what is the necessary deterrence to stop over-the-limit, and over-the-limits are a major source of fee.

Then a final area --

MS. BRAUNSTEIN: Don't you have to opt into those now?

MR. NAVARRETE: Yes, I mean, yes. I was going to --

MS. BRAUNSTEIN: That has got to--

MR. NAVARRETE: -- save my comments until the end of this, but, yes. The opt-in makes it an explicit customer choice.

MS. BRAUNSTEIN: I'm sorry. I mean, that's going to prevent a lot of over-the limit-fees. Some companies have chosen not to charge them at all.

MR. CALHOUN: Right. Because of the challenges, I think, in part of getting the opt-in consensus.

MR. NAVARRETE: But they will only opt in if they think the fee is reasonable. I mean, it's almost arguable that this entire framework shouldn't apply to over-limit fees because of the opt-in. I mean, a customer won't opt in to a fee they think is unreasonable.

MS. BRAUNSTEIN: I wasn’t going that far.

MR. CALHOUN: It seems that --

MR. NAVARRETE: The statute says--

MR. CALHOUN: -- you can argue on interpretation. It seems like Congress instructed the Board to go through this process for over-the-limit fees as well as to go through this process for late penalty fees. At least that appears to be how it is written.

The last area is a situation that has come up with late fees in other contexts and that is, can a company trigger the loss of a benefit on these same acts, and in particular the late payment?

Let me give the examples of what has happened in the residential rental market. Most states attempt to limit late fees if you are late on your rent. There is a fairly widespread attempt by some to address that in the following way. They will have an apartment, they will advertise it for $1,000 -- and I have had this experience from cosigning for a couple of children getting apartments -- they will advertise the apartment at $1,000 a month, if you talk to the person. You go in and sign the lease, and the lease says your rent is $1,200 a month. But if you pay on time, you get a $200 a month discount. But if you are five days late on your rent, it is $1,200. They characterize that as not a late fee, but rather the loss of a timely payment bonus.

It is not merely a hypothetical question, because there have already been some credit card offers disseminated that have that same feature. Here is your interest rate, but if you pay late, your interest rate is as much as 10 percent, 1,000 basis points higher. I would urge the Board to look at that area to make sure that the rule is not evaded by that practice.

MR. NAVARRETE: Thank you, Mike. I know we're over here, so we should probably cut off a very robust discussion. Again, we never have to worry about not being able to fill the time.

I just have two parting thoughts. One is, I hope that for the Governors and for the staff here or whatever, that you see that nobody is re-litigating the issue of good versus bad in penalty fees or some of these broader concepts. I think it’s a major sign of progress that what we are really talking about is the nuts and bolts of methodology. And that's, I think, just reflective of the great thought that this Council typically bring to these kinds of dialogues.

I also want to thank Governor Tarullo for reminding me of my first year of law school 20 years ago. A Socratic exercise of statutory interpretation. I can't tell you it's the best feeling in the world, but a very interesting one.

MR. CALHOUN: Anything else from anyone else on this issue? We do need to move on.

MR. GOLDSTEIN: Just a quick comment. I'm not entirely skeptical about the models, but I do think that there are potential problems with them. They will undoubtedly be hypothetical, and your business book will change with some regular basis, presumably, over the course of time. And the models will be imperfect.

I do think the Board could write in its regulation that, if you go down this path, the Board will, on a regular and routine basis, review the results of that model as to its deterrent effect and will quickly have those models either stopped or adjusted if they seem to be biased in one direction or another. That kind of strong caution seems to be well within what the Board's authority could be in writing the regulations for saying, you can do that, but if you do that, we are worried because we know they are imperfect, and we're going to watch you very closely.

MR. NAVARRETE: And that's explicitly written into the statute. That's what the primary regulator will be responsible for doing. I can tell you the OCC, and in talking with the Fed, has a very spirit-of-the-law perspective, not a letter-of-the-law perspective right now. So to

Mike's point about potential areas of evasion, that is absolutely part of the dialogue.

MR. CALHOUN: Well, why don't we move to our next topic here, which is foreclosure issues and the REO market. We had, I think, quite an illuminating and vigorous discussion yesterday.

As all of us know, the foreclosures continue to come. There are both high levels of delinquency and even higher levels of borrowers who are underwater. There also is an existing large inventory of REOs and predictions of a flood of REOs from a shadow inventory of REOs that haven't officially hit the market.

Yesterday, we discussed those macro situations as well as the Treasury's HAMP program, some of the challenges there and some of the challenges with REOs. I would like to turn it over to Saurabh, who is the chair of the Housing and Community Development Committee, to lead the discussion.

But first, I would like us to recognize the special sacrifice he makes by attending here. Saurabh is a new father and the proud father of a beautiful new daughter born very, very recently. Congratulations.

MR. NARAIN: Thank you, Mike. She was born last week on the 16th of March.

MR. RHEIN: So travel and sleep is good.

MR. NARAIN: Thank you, Mike. I want to also begin by thanking the Fed staff, Joseph and Jennifer, for organizing the materials and bringing the discussion forward to this point. I also want to recognize Patricia Garcia Duarte, who is the vice chair of the Housing and Community Development Committee.

There was a very robust discussion on foreclosure and REO issues, and the discussions really focused around three sets or main topics. What is happening with the HAMP program? Why are there so few permanent modifications? Based on the materials that we looked at, there are about a million or total active modifications, but only 168,000 permanent modifications. So, discussion focused on issues and challenges associated with the HAMP program and foreclosure remediation.

The second and third sets of issues focused on best practices, on other programs that are available in the market and have been successful for foreclosure remediation as well as managing temporary hardships and thinking about this as a temporary situation.

I want to start by requesting Larry Litton to provide the servicing perspectives to the challenges of the HAMP program.

MR. LITTON: Absolutely. I'm going to have a hard time sitting down talking about this issue, because I get kind of jazzed up about it. We had a very invigorating conversation yesterday about it, so let me try to give you some in-the-trench perspective.

HAMP has been good to the extent that it has created some industry standards, particularly for a lot of servicers that weren't doing a lot of loan modifications prior to the implementation of HAMP. However, HAMP has also created certain challenges as it relates to whether it casts a wide-enough net to capture enough borrowers. One prime example of that, which we focused a lot of energy on yesterday, has to do with the way the net present value (NPV) model works.

The net present value model -- the whole concept makes a lot of sense because we, as servicers, have to make default decisions that ultimately lead to the best outcome for the investor at the end of the day, because we kind of have a fiduciary obligation under the terms of our pooling and servicing agreements (PSAs) to service loans, to maximize loss reduction for those investors.

Prior to the implementation of HAMP, we all had kind of our own net present value model and methodology. However, with regards to HAMP, that now kind of created a new industry standard. Treasury released this model. I think that model was initially used by the FDIC with the IndyMac transaction.

I've got to tell you from my in-the-trench perspective, one significant challenge and significant problem is the way that NPV model works. In our judgment, particularly when I work with borrowers every single day, most of the loans that we end up denying for a loan modification are because of an NPV failure.

The primary problem with the way that model works is it utilizes what is, in my judgment, punitive and arbitrary redefault rates. The way that that manifests itself when I'm talking to Mr. Smith, who may live in Phoenix, Arizona, is Mr. Smith may fail that NPV test because the way the NPV model works is it may assign as high as a 90 percent redefault rate, based off of certain elements of his loan. The higher the loan-to-value ratio is or the lower the FICO score is, the more likely it is that he is going to fall into the higher band of the redefault rate. Well, those are the exact loans that we want to try to do something with.

When I worked a loan prior to HAMP, what I always tried to do was say, hey, the greater loss severity at the end of the day is where I really want to focus a lot of resources. I'm willing to take a little bit of risk there as it relates to whether I extend a loan modification or not, because my investor is going to lose 80, 90, 95 cents on the dollar.

But the way the HAMP model works is that, that exact loan that we are trying to save and avoid an 80 percent severity, if HAMP assigns a 90 percent redefault rate to it, in many, many, many instances, the vast majority of the instances, he fails the NPV test. Therefore, a loan modification is not extended.

I didn't mean to get too deep into the weeds, but that is a fundamental issue that, in my judgment, constricts the universe of loans that could potentially be modified under the HAMP program.

Then just two other just very, very quick points. The 31 percent debt-to-income standard, which we fully support -- we tried to lead the industry on using a 31 percent debt-to-income standard -- but 31 percent doesn't work in many instances and here is why. We have lots of borrowers that we work with where the borrower defaulted because of some prior job loss. So that borrower might be nine months past due and on the verge of foreclosure. He is now reemployed again, and his current income-to-debt ratio might be 27 percent, so he doesn't qualify under HAMP. Now, he can't pay the nine payments that are past due.

So what do we do about that? We either have to put him on a repayment plan, which increases the payment and increases the likelihood that the borrower will redefault or we have to offer a modification that is outside of the HAMP program.

One of the things that we have talked about with Treasury is trying to expand that window some way. I will say that Treasury has worked very, very hard with the industry to kind of ease some of the documentation requirements and those types of things, but we continue to have challenges in that regard.

Thank you.

MR. NARAIN: Does anybody else want to comment on the NPV or other issues?

MS. KEEFE: Sure. I too am in the trenches on the other side with the homeowners, and I really appreciate Larry Litton's comments. What is interesting about these meetings is I do get to have dialogue with folks like the servicers and realize how on common ground we are. I think a lot of the criticisms that you have are really issues that you have with HAMP that advocates are seeing as well, from a different perspective.

I think we, too, are having problems with the NPV model. We continue to push for that model to become publicly available. In our respect, we would love to have more information on the inputs. We question the inputs that Larry raised and also other inputs such as the value of the house using the automated valuation model (AVM) solely and not real appraisals, but also not being able to challenge those inputs.

I recently did a training. I work in New York and go around the state and do a lot of trainings around our settlement conference process for pro bono lawyers to represent homeowners in the settlement conferences in New York. New York now is the only state that has mandatory settlement conferences for all residential homeowners. We are trying to build a cadre of private lawyers to help homeowners in that process.

It really struck me, being in Queens doing this training for these private lawyers explaining the NPV model, and when asked the question when somebody is denied, do you get a reason why they are denied. And having to explain to them, well, we get a cursory reason. They were sort of stunned that the homeowner is not entitled to see the inputs that went into that model that denied them for what is really the greatest loss-mitigation tool out there for homeowners.

So we certainly need greater transparency in that for consumers, but also some of the other inputs, I think, we challenge. I continue to be dismayed that there isn't an input for another big reason for this program is to right a great wrong that we did for consumers and homeowners across the country by letting sort of this rampant unregulated lending devastate certain communities, that that is not included in the model.

I also think the window needs to be expanded in other ways. We continue to have problems with second liens. They continue to be a challenge. Homeowners are often caught in a catch-22 where they are below the 31 percent debt-to-income ratio when you consider just their first mortgage, so they have too much income, so to speak, to qualify for a HAMP review. But then they can't qualify for any other loss-mitigation option available by the servicer because they also have a second mortgage, and when you take into account the first mortgage and the second mortgage payment, they have too much debt-to-income ratio.

So there are still a lot of paradoxes in the system that need to be fixed -- not to also mention the issue of more and more folks being underwater.

We are also routinely hearing that folks who have a lot of equity are sort of categorically being denied HAMP modifications because it is always going to be in the best interest, if somebody does happen to have a lot of equity in their house, they are going to fail the NPV model, because the investor can just easily sell the house through a sale if there is a lot of equity and recoup what they owe. That continues to be another problem.

I would love to see as much focus on trying to develop and move HAMP forward on creating or developing alternatives to try to address these other problems. We have come up with a sort of one-size-is-supposed-to-fit-all solution, and it clearly is not. It is an easy model to look at and fall back on, but I think we need to really keep the emphasis on trying to address these other problems and come up with alternative programs, both within the servicers, but I would love to see Treasury start to focus on other programs to address some of these other challenges.

MR. NARAIN: Phyllis?

MS. SALOWE-KAYE: In New Jersey, for the past 15 years, our biggest business was first-time homeowners, first-time buyers where we made about 15,000 mortgages in the last 16 years with first-time homebuyers. All of those mortgages were with major lenders, below market-rate, 30-year fixed, no points, no PMI, very few defaults.

Now, we are in the business of foreclosure counseling. Our client base is about 6,000. We get about 85 new client calls a week, adding probably more than half of them as new intakes.

Our problem is that we are not moving any people out. First of all, we have huge counselor fatigue, and the program is actually costing us money because of lack of resources. We are not moving people out. Most of the modifications that we are getting are, first of all, not HAMP. It was great – I'm a first-time person coming here, to come here and listen to Larry and actually understand about this industry model and why some of our lenders are actually not offering up other modifications. It is great to learn that. We now have to fix that. Most of our modifications are not through the HAMP program, but through just our negotiations with the lenders.

We have a state mediation program that lenders are required to enter it if the homebuyer wants it. When we first set it up with the state Attorney General, they said it was going to take seven hours to do a modification for one client, and they would be gone. We said it was going to take about 27 hours. Now that we are going back and forth to court two and three times because we are not getting permanent modifications, we estimate that it is taking about 67 hours to do a loan modification, which clearly makes no sense.

So the points that Larry raised and that Kirsten raised are really important. We need to come up with other models that work. We also are still encountering major -- I mean, it's better than before, but the back office, the loss of documents, the chaos that is existing with some of the major lenders in terms of trying to modify the loans still exists. It is better than it was a year ago, but it's certainly not an industry model that I think any industry would want to put up there.

One final point. The administration's program now to push short sales and to incentivize realtors to do these short sales, we think that there needs to be and there should be a speedier, seamless process. However, I think that we should be concentrating on keeping people in their homes. I know yesterday we talked a little bit about, if the lender was willing to accept a $50,000 write-down on a short sale, why wouldn't they, I asked, want to accept it on a reduction of principal, which I think needs to eventually be a mandate here. The response was because other people who are on time would then become delinquent and they would want to modify their loan -- they would want a reduction in principal and it wouldn't be fair.

I think that by the time a homeowner gets to the point where they are in foreclosure, their credit has been so destroyed, we can look back and see that this isn't just somebody who wants to default on a loan so that they can get the reduction in principal. I think guidelines could be set up to determine how those reductions in principals were happening. I think we need to look to keep people in their homes, to maintain the neighborhoods and not open up a home market for speculative buyers and also predatory Realtors who are pushing or could begin to push delinquent homeowners to do these short sales.

MR. NARAIN: Kevin?

MR. RHEIN: Just in the area of what else could we maybe do to try to improve flow-through? I think Larry spoke very well about the problems with the NPV model.

The other big thing that we run into is this 31 percent debt-to-income. There is nothing in the model that really looks at unemployment and under-employment. If there was a short-term, six months to two years type of workout program, so that you are restructuring a loan without it being a permanent modification and letting somebody get back on their feet, and then maybe there is a piggyback that comes once they are reengaged and reemployed.

To Larry's example, the person at 28 percent DTI, initially they had nothing. They couldn't have qualified. Now they are at 28. If we don't address the unemployment and under-employment issue and the ability to qualify for a mortgage, I think it's going to continue to be very problematic overall. I think that would really help a lot in a lot of situations.

MR. NARAIN: Patricia.

MR. DUARTE: I also want to reemphasize the fact that the one-size-fits-all solution is not working, especially in Arizona. It was very revealing and a big ah-ha moment yesterday in hearing Larry. Why in Arizona are we not getting more modifications? Well, the net present value calculation will never work. Our values have dropped, more than half in some communities. Overall, I think the latest number is like half across the state. There are pockets in new subdivisions in the suburbs that have lost like 60 percent as well.

So we need a different solution for Arizona. We are grateful that we are getting some TARP money coming our way. There is $125 million. The projections are 50,000 potential foreclosures this year. Unfortunately, the $125 million could maybe help 3,000 people, maybe 5,000. So it's a huge problem. The states like Nevada, Arizona, Florida, California, we really need a different approach.

Things have gotten a little bit better. NHS Phoenix is piloting something with Freddie Mac where we have a borrower's help center. It's too early to tell. We just launched it February 1st. We are participating with Hope Now where we are uploading documentation via the web. It is very early to tell what the progress on that is. The hopes are that we can get responses in 10 days. We still have to test that. I know other peer organizations in the NeighborWorks network have had some progress, especially NHS in Chicago.

So we are hopeful. But if net present value and those redefault calculations are against us, then we are not going to see much progress, so we do need to change the approach for the hardest-hit states.

MR. NARAIN: Thank you, Patricia. It is clear that the new models apart from HAMP need to be sort of considered and thought about. One of the comments that Larry mentioned yesterday is HAMP becomes the standard and that's where people want to go. How do we encourage customers and lenders to think about other new mechanisms to help the foreclosure remediation program?

I'm going to start with Brian to talk about some of the programs that Pennsylvania has put together.

MR. HUDSON: Thank you, Saurabh. Yes, the program that we are operating in Pennsylvania was started in 1983 as a result of the downturn of the steel industry. Families were being hurt, foreclosures destroying communities. It is funded entirely by the state legislature. Since 1983, the legislature has appropriated $233 million. It has been repaid $250 million since 1983, so it is a very successful program. We have saved over 44,000 homes from foreclosure. We have lent actually $453 million under the program. It is a revolving loan program. The minimum payment is $25 a month until the homeowner can get back on their feet.

It is an unemployment program, so, Kevin, it does hit to what you were just mentioning regarding a bridge to unemployment to get people back to work. And it's exactly how HEMAP, it's the Homeowners' Emergency Mortgage Assistance Program. The acronym is HEMAP. Delaware also runs a similar program called DEMAP. North Carolina has started a pilot, and I know the states that received the money for the TARP are looking at unemployment-type models like this.

The homeowner has to be in that situation for no fault of their own. Normally, it is the loss of job or a medical reason. We use the counseling agency network to take the application form. They are our first line of offense, if you will. Send the application in to the agency. We make a decision and make either a continuing payment to the lender for up to 36 months or just an arrears payment to bring them current. Some homeowners have already gotten reemployed and are back on their feet, but they are behind on their mortgage, so we do two types of payments, continuing and non-continuing.

The homeowner has to recertify their income annually. It's at that recertification process that we determine, can they afford to pay more, and then we put them on a repayment plan.

The average loan under this program is about $10,500. So you can see it goes a long way to keeping that homeowner in their home when you look at the cost of carrying a foreclosed property and the destruction that occurs from destroying these neighborhoods.

We were in discussions with Treasury about creating a national model tied to unemployment. Of course, the TARP money was announced initially for the -- targeted to those states that had the highest percentage of underwaters. We are all working with those states to have a success in those states, because I think this is another tool that could be used to provide that bridge while jobs are being created for homeowners to keep them in their homes. Thank you.

MR. NARAIN: Thank you, Brian. Dory, I know you put together a significant amount of work on other programs that are working. Some comments to that would be useful.

MS. RAND: Sure. Woodstock Institute is not a direct service provider or housing counselor, but we have been doing some research on the foreclosure crisis's impact on communities and also working with the Federal Reserve Bank of Chicago and NHS and others on some regional collaborations.

One of the things that we are going to be helping with, modeled on the Philadelphia court system program, is a mediation program to help prevent foreclosures. I understand that one has been very successful. Judge Annette Rizzo has presented on it several times.

There has been some development of new land banks. There has been legislation passed in Illinois that will give municipalities more authority to deal with real estate-owned or lender-owned properties post-foreclosure. We think there is going to be a lot greater need for community-wide or neighborhood-wide solutions because so many of the foreclosures and REO properties are concentrated in the lower-wealth communities and communities of color.

One of the things that Woodstock found in some recent research is that the length of time that properties stay in REO or lender-owned status post-foreclosure is significantly longer in communities of color. Those areas are going to take much longer to recover from the economic crisis, and I think we are going to need some more targeted programs to address that.

MR. NARAIN: Mary, did you want to comment on the long-term view that we talked about yesterday?

MS. TINGERTHAL: Indeed. I would like to take just a minute to talk. A year ago when I came on the Council, we were just beginning what I would call the local neighborhood stabilization efforts. The Neighborhood Stabilization Program from HUD had just issued its contracts, and the National Community Stabilization Trust (NCST) was just beginning to transfer properties.

I had the opportunity last week to spend a couple of days at Harvard with 12 of the cities and states that have received money under the NSP2 program, which was just announced about a month ago. Those dollars are being administered in somewhat different ways than the NSP1 program and I think have some potential for hard-hit communities like Michigan, like Phoenix and like Cleveland, to really continue the work of neighborhood stabilization that really just barely got started in the second half of last year.

I think that with the slow start, we are beginning to turn some things around. NCST has seen the trend that we talked about yesterday of delayed foreclosures where a foreclosure will be started and then not completed in the time frame that you would expect. It has a lot to do with HAMP, mortgage modifications, but also has a lot to do with very low-value properties that lenders are not choosing to bring through.

With that, market conditions are very, very different from place to place. Where in Phoenix or Las Vegas it has become very difficult for homeowners, in many cases, to compete for properties, because the values have sunk so low that investor-owners are coming in and snapping up properties and making it very difficult for borrowers that are not cash purchasers to compete. So a lot of different dynamics around the country.

What I talked about yesterday is that the one point in meeting with these 12 cities last week where there was universal agreement that there was not progress and that there needs to be progress is one of the things where I think the Federal Reserve truly can be helpful. That is that across the board, no matter what kind of city it was, there was agreement with the fact that mortgage financing is extremely difficult to obtain in neighborhood-stabilization neighborhoods.

FHA right now is critically an important tool. It is being used mostly by first-time homebuyers. It is a very necessary tool, but it's not a sufficient tool. The GSEs, as we know, are still somewhat in limbo. Thanks to the Fed, they have been able to sell their securities. But from an origination standpoint, there have been over 500 changes to regulations or rules or practices within the last several months, making it a real challenge for the mortgage originators to know what they can and what they cannot sell to the GSEs.

Importantly, the private securitization market simply is not back. It simply doesn't exist. As we think about what is going to happen with the market for long-term, fixed-rate mortgages, I simply don't see banks ever going back to holding 30-year, fixed-rate mortgages on their books, so securitization, if we're going to have a healthy mortgage market, really has to come back. And that's where I think the Federal Reserve can be helpful, stressing the important within the industry that it is critical that we restabilize a healthy and reformed securitization marketplace.

I think there are a lot of things that can be done without formal regulatory reform. I think convening the leadership of the major banking organizations that can, have, and will do securitization in the future and begin to chip away at some of the accepted practices that get embedded in pooling and servicing agreements that we know haven't worked very well during the recent crisis.

Some of those things can be changed. They are not regulatory. They are simply practices that have evolved within the industry that require certain decisions to go back to investors, rather than residing with the servicers, and that do things like not require trustees to disclose on a regular basis who might be servicing a mortgage, so that you could actually find out who it is you need to be talking to for a loan modification or whatever.

I think there are some nascent things that are happening in the industry. The American Securitization Forum last summer announced its Project RESTART, which is a requirement for annual data to be submitted by mortgage loan servicers, so you are not dealing at a time when a mortgage forecloses five, six, seven years after it was securitized of only having the data that was there when the mortgages were originally securitized. I think there is some real promise there, but there are some things that it doesn't even address, like a second mortgage coming onto the property, which has proven to be so troublesome.

So with that, I would like to just encourage the Federal Reserve during this time, when formal regulatory reform is taking its own due time and deliberate speed, to really think about the role that you can play in emphasizing the importance of a healthy mortgage securitization marketplace going forward with the industry leaders. Thanks.

MR. NARAIN: Thank you, Mary. One of the things that I do want to chip in on here is the fact that, as many have mentioned, the lack of availability of loans for remediation and other facilities. I have seen in our work that several of the local community banks and local CDFI banks have stepped up and created partnerships with nonprofit organizations, such that there is a temporary solution to help people get out of this temporary problem and then help them get back into a long-term home ownership solution.

One particular case in point is a bank in Minneapolis/St. Paul, which has worked with the local finance agencies to create short-term lending programs there and help people get back into borrowing.

Kevin, I think you were talking about some of these partnerships.

MR. RHEIN: Well, actually, it was more along the lines of how do we deal with other real estate owned (OREOs). It was actually working with Mary's organization. Wells Fargo had some really good success in a pre-OREO notification to an organization like National Community Stabilization Trust. They have had borrowers lined up. They are ready to go in and do what needs to be done to the properties. I think it is a great example of non-profit and for-profit organizations working together.

It really minimizes the time that property is an OREO, and we all know that's what really drives down neighborhood values. Greta, I think you were talking about this yesterday, on the impact that starts to have overall. It is early. I think, Mary, you said you have done about 1,500 properties. Some of that, I think, reflects the -- it's always tough to get started, but you start to build some momentum. I think the slope of the curve is good in terms of more stuff coming on, but we need more programs like that and how we can partner together.

Maybe, Greta, you want to?

MS. HARRIS: Our national organization doesn't actually serve consumers on an individual basis, but in the aggregate at the neighborhood level, primarily in low-wealth communities and communities of color. My particular territory covers from New York down to Miami and parts of the Midwest, so I have the opportunity to actually work with our local offices on the ground in that region to really see the impact of foreclosure on neighborhoods, both on families and the communities.

I agree with Phyllis wholeheartedly that the best strategy, if at all possible, is to keep families in the home, whether it is create a financing, like what they are doing in Pennsylvania, or other programs so that it has less of an adverse impact on the family and the surrounding neighborhood.

If you can imagine, just thinking about your own home, if your next-door neighbor vacated the property and now it is sitting there empty next to you on a regular basis. Then if you go a little bit further and think about maybe it is four or five houses on your block that are now sitting vacant, that's really an uneasy feeling that is going on.

There are some communities that I have had a chance to visit where we walked the block, and it is only four or five neighbors that are left on a particular block where 20 houses are vacated. It feels like a bad sci-fi movie almost, and people are just frightened to death about what their choice is and what their future will hold.

Generally, once the property has been foreclosed upon, it is a very long lag time between what is going to happen next to it. Generally, the new owners of the property that have just recently foreclosed on it are not necessarily the best property managers. I am dealing with a couple of deals down in Miami right now where the lenders are in Houston or in California that really don't have a real direct link to what is going to happen to the future of that vacated property.

A lot of the burden -- the cost burden and the actual human capital burden -- is falling onto local governments having to deal with boarding up the property, having to deal with cutting grass, having to deal with increases in fire and police calls that are coming in. There are increasing numbers as people are desperate, going in and ripping out anything that is left in the property, trying to get to copper, trying to get to HVAC units, and really deteriorating the asset value of that property even more.

We are also seeing, typically, a range of 15 percent to 50 percent valuation drops, especially in targeted neighborhoods of color where people who have gone through credit counseling are usually folks who did nothing wrong. They paid their mortgages on time, and yet the equity that they have built up in their properties is just disappearing because of the neighborhood valuation drops.

Where we are seeing purchase activity starting to come in, it is the investor market that is coming in that is not usually committed long-term to the well-being of the community. Short sales are becoming maybe necessary, but they are devastating to hitting the valuation bottom of the neighborhood, so that we can start to rebuild the market value there. With every short sale, the spiral of valuation decreases, just continues to go deeper.

On the good side, there are some early signs of progress through public, private, nonprofit coalitions that are coming together. We are looking at doing things like data gathering, which is not sexy, but necessary to inform strategies that can begin to positively impact neighborhoods. It is also important in determining who the owner is, because what we are seeing a lot of now foreclosures get started, the family moves out, but the institution doesn't finish the foreclosure, so the property is in limbo as to who do you go to if you even wanted to acquire it and try to bring it back to a useful light.

There are site-control and site-assembly challenges that are out there, looking at these complex title issues about ownership and also identifying acquisition and rehab capital to be able to move that property forward.

Then we are also needing to work very closely with counseling agencies, realtors to be able to have a pipeline of qualified buyers. As Mary talked about, there certainly is a need for increased mortgage capital. But again, on the front end, the short-term financing of acquisition and rehab financing is also critically important for our nonprofit partners who are willing to go into those communities and help stabilize and rebuild the markets.

As a nonprofit industry, we are trying to put our heads around it. We are in this for the long haul. This is not going to be a quick-fix issue. While we see lots of different programs that are coming in and they are addressing a couple thousand units, we are talking about tens of thousands of properties that have been impacted, so we need to work in partnership with the Fed, industry, local government, and nonprofits to try to get capital flows, both short-term and long-term, coming back into these communities, so that we can help rebuild market value.

MR. NARAIN: Thank you, Greta. Jim, did you want to comment on this one?

MR. PARK: Just real quickly. Greta obviously hit on all the major points of sort of the devastations that these foreclosures are having on communities.

One thing that I think people have seen in industry over the last year, you have seen a pretty aggressive influx of investors. I think it is absolutely right -- if you look at just the pure numbers, in places like Phoenix, more than 50 percent of REOs being purchased by investors, not owner/occupants -- the same thing with Las Vegas and Florida. I think this temporary shrinkage of REO inventory has created excess demands by investors.

I think the industry, and I think you talked about some of the scalability of the solution that is needed to deal with this issue, is really critical, because we are not talking about a couple hundred properties here. We are talking about thousands and thousands.

I have seen some pretty interesting ways of dealing with the investor issue. I think more recently Fannie Mae actually put out a requirement that the first 15 days only owner-occupants can bid on their REOs. HUD has had similar requirements for some time, which was, I think, 30 days. But I think as an industry, those are the kinds of things that are going to be required to give some leg up to the owner-occupants, first-time buyers and others in this current market, because they are being outbid or out-maneuvered by investors across the country.

I do think we have to come up with a strategy that kind of provides a wholesale benefit, a wholesale kind of advantage to people who are going to live and stay in those communities.

MR. NARAIN: Thank you, Jim. We might have time for just two last comments. Mark, do you want to comment on some of the efforts in Cleveland, and then Mike Griffin.

MR. WISEMAN: Thank you, Saurabh. There is a real disconnect that we don't have time to discuss here, but I think needs to be fleshed out at levels much higher than this. There is a disconnect between the borrower's desire to stay in a home and how willing servicers are going to be to help them stay in that home.

I think the REO problem is sort of a window into that. If you look at the Case Western Reserve study that was included as part of the materials, they studied REO properties from 2005 to 2008 in Cuyahoga County, and they looked at how many of the REO properties sold for less than $10,000 apiece, being the first post-foreclosure REO sale. In 2005, 3 percent of the REO properties that were sold by the lender who purchased the house -- I have to sort of give a little bit of background.

A foreclosure sale, at least in Ohio, is not an auction. It is a fixed sale. The front row is reserved for lenders' attorneys, and they go in and they can up-bid the property until it gets to the point where they are happy with it and then they become the title owner of the property. That ends up being about 99 percent of the properties because, as we all know, the appraisals and the loan amounts are way higher than what the property will get, so third-party investors are not going to come to the auction and buy the property.

In 2005, 3 percent of those post-foreclosure REO properties that the foreclosing party bought back at sale went for less than $10,000. By 2008, 42 percent of those properties that were sold by the lenders who bought them at sale were sold for less than $10,000. That means in each one of those sales, the borrower could not stay in the house and was chased out for whatever reason, and then the lender took on the back end less than $10,000.

Now, it's a whole other daylong seminar to talk about PSAs and what they say and what they mean. But I have heard in Congressional testimony and in articles and on the phone and in meetings, lenders, and servicers talk about the PSA doesn't let us do X, Y, and Z. Larry talked about the problems that Litton has with the NPV model and how it stacks up with his investors and whether he can make deals. But there is a real disconnect, because I guarantee that there isn't a single PSA that says, don't work the borrower out and take pennies, literally pennies on the dollar when you sell the house at foreclosure sale.

This could not highlight more exquisitely how important HAMP is and the other Administration efforts to push workouts down the chain and to help work people out, because there are entire neighborhoods that are being decimated. Some neighborhoods just will not come back from something like this. They are not just in Cuyahoga County. They are everywhere.

That disconnect has to be connected at some point. Someone has to figure out exactly what the PSA says, exactly what flexibility the servicers have and why in heaven's name these loans aren't being worked out. When people call their servicer, and I have been on these calls and I have represented these clients, and you say the loan is $90,000, I have someone who can buy it at $85,000. No, I'm sorry, we're going to go full speed ahead.

I know Kirsten can back me up on this, but when you are in mediation or trying to work out a loan with the lender or servicer – I'm sorry, if you're not in mediation and you're just trying to work out the loan, the foreclosure attorney will not take his foot off the gas pedal to get that foreclosure through and get judgment and get it to sheriff's sale.

Unless we all recognize that that tension exists, we are spinning our wheels and none of this is really going to make a difference. So I'm ecstatic that we are talking about the REO problem, because I think it is part and parcel of what is going on here with HAMP and the other efforts.

MR. GRIFFIN: After Mark painted such a great picture of Cleveland, I hate to leave it on that note. I do want to point to some of the materials. A program similar to what Greta talked about in Cleveland, Opportunity Homes, where the nonprofits, the city, we as a lender using New Markets Tax Credits have come together to try to really address the issue and do triage. The goal of this program certainly is to set up a model, but it is to demo 100 homes, to maintain 100 people in their homes who are having mortgage issues, and then also to help reestablish the market in the city to rehab and sell those homes to qualified homebuyers.

Currently, again, it's very small numbers, but we have sold 11 of those 19 completed homes for an average sale price of $93,000. So there really is opportunity. We very much have targeted this to specific neighborhoods. We, like many other cities, I believe, need to recognize that our cities are shrinking, and we have got to focus on the areas that we can really salvage and maintain for the future.

MR. CALHOUN: Thank you, Saurabh, for leading this discussion. I think it comes back full circle to where Larry started us -- that the NPV test is not working. These recent comments are -- it's not capturing the externalities of what it costs the neighborhood to see a substantial number of the homeowners converted to either vacant properties or investor-owned properties.

We are running about 15 minutes behind on our schedule, so if folks can come back in 10 minutes, that's 25 after, we will start our last committee discussion on short-term and small-dollar loan products. Thank you.

(Whereupon, the above-entitled matter went off the record at 11:15 a.m. and resumed at 11:27 a.m.)

MR. CALHOUN: We have two main areas left to cover. First of all, the Depository and Delivery Systems Committee looked at short-term and small-dollar loan products. Then we also have our open-comment period following that. We have 35 minutes set aside. We may have to trim that down to 30 to stay within our time limit here.

So I'll just turn it over quickly to Kevin, the committee chair.

MR. RHEIN: Great. Well, thanks, everybody. We covered two main topics in the working session. We spent quite a bit of time on clarification around some of the overdraft regulations, and we're not going to talk about that now. We are going to specifically talk about the short-term borrowing.

There was quite a bit of passion around, specifically, the tax advance loans. Dory, do you want to -- you had some strong opinions on this, so why don't you tell us about it?

MS. RAND: Sure. Refund anticipation loans (RALs) are provided through for-profit tax preparation companies with assistance from banks that make the loans, and the tax preparers are acting as their agents.

What Brookings Institution research shows and others is that these kinds of loans are targeted to Earned Income Tax Credit (EITC) recipients, low-wage working families, communities of color. They are disproportionately used by EITC recipients and persons of color. As a result, they seriously undermine the effectiveness of the EITC program, wasting about half of all of the EITC dollars going towards payment for these tax services and loans.

The tax preparation part, I understand. People need help with getting their taxes prepared. But the loan part is so unnecessary and so abusive, because if people had a basic bank account that they could directly deposit their refund into, they could get their refund for free within about 10 days or less. As the IRS and Treasury are working to improve that system, that will happen even faster.

Basically, we are allowing the banks to participate in these products that really have no value to consumers and to society and that dramatically strip wealth from low-income communities and communities of color.

I think that I would like to see the Federal Reserve and other regulators put a lot more emphasis on outreach to the unbanked. We know from the recent FDIC study, for example, that half of the unbanked in this country were formerly banked, but now they have blemishes on their credit record that are preventing them from getting back into mainstream banking.

I think we could be doing more to encourage banks to bring them back into the system by offering things like second-chance checking programs and also doing more to use tax time as an opportunity to save and build wealth instead of strip assets through these loans.

I think it's important that each of the regulators have regulations and not just guidance. We have seen through some of the other regulators that guidance has gone unenforced for years and that there is a lot of abuse with these refund anticipation loans. The tax preparers on the ground have been found guilty of fraud and deceptive practices in numerous court cases, so there is safety and soundness risk, litigation risk, reputation risk. There have also been examples of very offensive and racially discriminatory advertising and targeting of these products that I think are a huge embarrassment to the banks involved in these loans.

So the consumer advocates who have been working on this issue for years really would like to see this product completely eliminated. In the meantime, I think they need to be regulated. I don't know if it is really possible for the banks to adequately supervise these tax preparation companies that they partner with and who are acting as their agents. There are thousands of them all over the country, and they are not being adequately trained and supervised and taught how to apply the fair lending rules.

So I would appreciate your attention to this issue.

MR. RHEIN: We're going to go to Phyllis in just a second.

Just for clarification, none of the banks represented here offers this product. So, just to make sure everybody understands, we’re bad guys most of the time. But it is interesting, because we didn't get any other perspective from somebody who does. I think the general sense, as we went through this, is these are not a good thing and yet we didn't have anybody here to say, well, here is why we do this.

Just for what it's worth, I'm not trying to defend them. I just want to make sure that there was nobody here to represent the other side.

Phyllis, you had some experience here.

MS. SALOWE-KAYE: Four years ago, we opened our first Volunteer Income Tax Assistance (VITA) site in the city of Newark and then we expanded to Camden in New Jersey. The first year we didn't offer any RALs at all. Year two, J.P. Morgan Chase came to us and they offered to set up a free RAL with us, with them picking up the cost of the RAL. So we did offer it in year two. We did the taxes of several thousand people in year two, but we provided them with financial education. In year two, only five of our several thousand clients took a RAL.

I will say that from the beginning, and some of the banks who are here were a part of this, we participated with lenders to have a table in our office where they would alternate on alternate days. Different banks would be there opening up the checking accounts that would be beneficial to the clients.

We told the clients the difference, and we really wanted to develop the mindset away from RALs, so if they moved or they didn't come to us the following year or they didn't want to stand in line for two hours, because we have very limited resources, that they would not go get these RALs. So in year two, we made five.

In year three, J.P. Morgan withdrew from doing them for free, but TD Banknorth came out with a free one that they offered. We chose not to offer RALs and instead concentrate on financial education.

Unfortunately, we can't compete with those somewhat racist ads that are on television all the time. We are not able to reach as many people as the for-profit tax preparers are to lure them in with the promise of an immediate return and very seldom having them understand how much this is actually costing them in the end out of their return, out of their EITC return, which they have come to include as a regular budgetary item that will pay for food, rent, utilities, and things like that.

We would also like to see them gone. We know you have done some regulation of it, which we appreciate, but we see no need for it. We have more clients than we can serve with the funding that we have. We just think that the clients who do go to the for-profit tax preparers where they have to pay money should not even be pushed into these products, so we would like to see you get them out of here.

MR. RHEIN: Kathleen, you had a perspective on refunds coming on cards. Did you want to talk about that for a second?

MS. ENGEL: Yes. I mean, I think if everybody agrees that we can get rid of RALs, it really doesn't matter. But I'm a little bit concerned about the prepaid debit cards, which are the way the proceeds from the loans are often issued. I think, generally, the prepaid debit cards can be a good thing, and it avoids the problem of having to set up a bank account and things like that.

But one of the things that happens with the prepaid debit cards that are provided by the tax preparers is that they become a mechanism for the tax preparers to track how the consumers spend their money. That information is then available to them for, I think the industry calls it, cross-marketing, but in general marketing other products to them. So that, for example, they can find out who are the people who go out and buy high-definition TVs and who spends their refund all in one day versus the people who use it to buy groceries and things like that. Then they get a lot of information about the borrowers' behavioral patterns that then they can use for marketing and potentially sell to other entities for marketing.

It feels to me that that's not where we want our EITC money going, to support the gathering of information and marketing of potentially further abusive products to vulnerable people.

MR. RHEIN: Okay. We want to go to Mike and then Jennifer.

MR. GRIFFIN: I agree that we shouldn't be using the transaction data to market to people, but I guess I don't want to leave the impression that prepaid debit card reloadable is necessarily a bad thing.

Having worked diligently to reach the unbanked at Key, I know sometimes that is a product that people want. They don't want a checking account. They don't want everything that goes with that. They want a piece of plastic that they can safely carry around, that they can do their transactions with, that they can pay their bills with.

It becomes the checking account for them. Certainly, there shouldn't be abuse of the information that is gathered from that, but it really can be a very good product to reach the unbanked people who are using check cashers and payday lenders now. I just want to make sure that that's out there.

MR. RHEIN: Yes, and just --

MS. ENGEL: I agree.

MR. RHEIN: -- to put a point on that, many of the government programs now, unemployment, Women, Infants and Children Programs, all of those are moving to electronic distribution, much of it on reloadable cards. So it certainly is --

MS. RAND: Kevin, if I can follow up on that? That's a great point, because the debit card approved by Treasury -- I think it is called the Direct Express card -- for delivery of government benefits would be a great vehicle for direct deposit of income tax refunds. We have asked Treasury to consider expanding the allowable use of that card for this very purpose.

MR. RHEIN: Jennifer, do you want to?

MS. TESCHER: Yes, just a couple of things. On this last point about Direct Express, Dory is right. Treasury is looking into the possibility of taking the good experience they have had there and using a prepaid debit card as a possible settlement option for folks who are receiving federal benefits like Social Security -- this is by choice of the consumer -- and applying it in the tax moment.

I think the challenge is that with a recurring benefit like Social Security, there is something coming in every month, but tax time is a single moment in time, one settlement. I think that has been one of the challenges.

But I think the most exciting opportunity, as you have heard from others, is that the tax moment is an incredibly powerful moment. It may be in some cases the one time a year someone is paying attention to their finances. It is in many cases the one time a year where they are getting an incredibly large sum of money.

So it is a really powerful time to talk about how to manage that money, how to make sure that you are going to get that money quickly, safely, be able to not have to spend it all in one place. I think that, for all of those reasons, prepaid debit cards, along with bank accounts and other kinds of products and services, are an important option. I think we should be talking about expanding the options for consumers to get connected to the mainstream, and I think prepaid can be one of them.

On the RAL issue, in particular, I want to say that I think the Fed has an important role to play along with other regulators, because tax preparers have a first-mover disadvantage here. RAL customers are the most unloyal, if you will, customers. Tax prep companies make money when you come back year after year to have your taxes done. Folks who want the RAL will go where the RAL is. So if their tax preparer stops offering the RAL, they will simply go to the next provider down the block who is offering it. No one really has an incentive to go first here and stop offering the product. That's where I think regulation can play a really important role.

MR. RHEIN: Let's do Corey, Kirsten, and we'll come to Alan.

MR. STONE: Our de novo community development bank in New Haven will be, as one of our core offerings, bringing checkless checking accounts with a debit card feature to underbanked people, along with money services that we will offer in our branches. We will be offering an instant issuance product to VITA sites for people who don't have accounts, so that they can have a place to deposit funds.

My personal experience as a VITA preparer is that people who come to a VITA site for the first time are generally pleased and surprised at how quickly the funds are available to them. That suggests that at the paid preparers, they are led to believe that the availability of their funds is at best uncertain or will take a long time, and therefore the RAL is their best avenue for getting certainty of funding.

Just understanding the economics of the preparers, as Jennifer was suggesting, it really is a race to the bottom where the preparers sell and market on the basis of the prep fees and make their money on the combination of those fees and the RAL fee, which is less transparent. Without some kind of cap on the RAL fee, it would be very difficult for them not to sell on that basis.

So I would be in favor of a 36 percent usury cap on RALs. It would drive down the cost of those advance funds. It would certainly result in higher prep fees, just to make up for the lost revenue over time. But my hope would be that that would drive more people to the VITA sites where they would get funds in a timely way and increasingly with the partnerships that are happening between the nonprofits and depositories bringing account products to folks who don't have them.

MR. RHEIN: Corey, I'm not sure I understand. What is a VITA site?

MR. STONE: Volunteer Income Tax Assistance is the IRS's program for providing tax preparation assistance to low-income individuals. It is offered through nonprofits that contract with the IRS pretty much nationally.

MR. RHEIN: Thank you.

MR. CAREY: We can get you trained as a tax preparer, definitely.

MR. STONE: Well, when I'm out of the card business, I'll need something.

MR. RHEIN: Kirsten?

MS. KEEFE: Corey said much of what I was going to say and also sort of questioning that consumers want RALs. My organization runs the VITA sites in Monroe County in upstate New York, and our experience is similar to what Phyllis experiences.

The first year we took on the VITA site program, 500 to 800 of the consumers that came in had gotten a RAL the previous year when they went to a paid preparer. About the same number inquired about a RAL product. Our organization, in partnership with the credit union, was offering a responsible RAL product and the same number, five people, ended up getting one.

I think it almost shows that the fraud that Dory mentioned that courts have found on the part of tax preparers is almost inherent in the selling of RALs by the paid tax preparers. When someone is really told that they will be getting their refund within a reasonable time period, they don't have to pay these big fees and especially if they open up a bank account, they will get it even quicker, it's not a product that is needed.

More so, though, the interest rates on these refund anticipation loans are 300 percent and more. There is no rational relationship between those interest rates and the risk incurred. If anything, these are the most secured loans in the world because they are backed by our federal government's dollars. There is no reason on earth why the banks should be making these loans at such outrageously high interest rates. I would push the interest rate to even be lower than what the military cap is right now of 36 percent, because in New York state we have a 25 percent usury cap on small loans to consumers. The only reason why these loans are being made in New York is because they are being made by banks that are nationally regulated and don't have to adhere to our 25 percent interest rate cap.

So, short of getting rid of them altogether, which I certainly would encourage us to do, I would certainly lower the interest rate to even below 36 percent into a rate that really represents the risk incurred for lending somebody government-backed dollars for 10 days, which is pretty minimal.

MR. RHEIN: Alan, do you have a comment?

MR. CAMERON: Yes, thanks, Kevin. I also want to join all of these folks in saying what a bad product this is. I, like Corey, have also been a VITA preparer and have seen the need for the Earned Income Tax Credit by taxpayers who are at the lowest end of our economic spectrum. And the RAL offer takes that money away. In the excellent white paper that the Woodstock Institute did, it was some $900 million in 2007. It's an incredible amount of money.

It is clear that the time to act is now, and the question is how to act. The OCC, just a month ago, issued a policy statement on this, telling banks what they expected in terms of their offering and support and sponsorship of these programs. That's all well and good, but we should have learned a long time ago, such as with the interagency guidance on overdraft protection in 2005, which after four years evolved into an overdraft rule by this Board. Rather than wait another four years with the policy guidance, it clearly is not going to work. It clearly is not going to be enforced responsibly.

This Board should take the initiative today to regulate this area, regulate it in ways that have been suggested here today, and to ensure that these products, if they continue to be offered, at least are offered in ways that are fair and transparent and not offered in the coercive environments that they are offered today.

MR. RHEIN: Andy, comment?

MR. NAVARRETE: Just a couple of comments. I'll join the chorus of folks who would like to see this product eventually disappear.

I suspect that there is some element of market forces that will push that, either a combination of technology, which is to Kirsten's point, this product is unnecessary. At some point, hopefully, that will be better understood. Some component of regulation here ought to be more education about just how fast technology now allows us to get our tax refunds.

I took one of these things out when I was in law school and an impoverished student. Then I was gaining six weeks, which made all the difference in the world in April when your loan money runs out. Would I have done it for two days? No. And so that is, I think, the kind of education process that could be a component of this.

With respect to this and its tie to prepaid cards, there is also an element of commoditization of a product. Think about all the things that we used to pay for -- excessive amounts of money for long-distance service, for e-mail, et cetera. All those things are now free or tack-ons to other services, I would suspect. And you have already seen this in prepaid, that the prices will come down as the product becomes more widely available and there is more competition. So that's another element where I think, ultimately, we get to something good here.

The last point I'll make is about getting banks out of this business. From a reputation perspective and from a safety-and-soundness perspective, unequivocally perhaps a good thing, but I would caution that what that typically means is that it gets driven to far less-regulated entities.

The thing that distinguishes a bank from a non-bank is the ability to take deposits, not the ability to loan money. Anybody can lend money, typically with a state license or perhaps no license at all. So I would imagine that you will have more than enough players out there willing to fill this gap in a way that is far less supervised, far less regulated than it is today. That's just a word of caution as we think about the next step in this process.

MR. RHEIN: Just to put a point on it, Kirsten, you had mentioned about some of the check cashers coming into New York, sort of filling that gap. We kind of talked about the efficiency of the market that, when there is a need, somebody comes in.

MS. KEEFE: Right. Right now in New York, because we have the 25 percent interest rate cap, we have been able to keep payday lenders pretty much out of New York. They have started to creep in through the Internet, and we are dealing with more people getting payday loans through the Internet now or by phone solicitations. But for the most part, we don't have the storefronts. We don't look like Washington state or some of the southern states, luckily.

Just recently, the check cashers got legislation introduced in New York state that sounds very pro-consumer, and they want to initiate a small-dollar loan product in New York state that would be regulated by the Banking Department, although our Banking Department does not like the legislation, thank God.

But the point is that I am very worried about the check cashers and other sort of ancillary financial services programs coming into New York and offering these small-dollar loan products. I have always said we need a subprime small-dollar loan product, other than credit cards, for folks. That is a huge need in the community. I would love to see the legitimate banks develop or try to develop some product across New York.

The credit unions, the community development credit unions typically have a loan product that is $500 or less for consumers that is also available for more subprime consumers, but we certainly need more of it. I think we have to be very vigilant about the other financial service providers in the world that are really unregulated coming into the market and really taking advantage of folks.

MR. RHEIN: Jennifer, yesterday you took us down a path of, okay, we've talked about RALs, so what do we talk about in terms of other small-credit availability?

MS. TESCHER: Yes. Andy and Kirsten sort of started us down that path, so I want to build on their comments because we shouldn't forget that, regardless of what we think about RALs or many of the other products in the marketplace, there is a dramatic need for credit among this consumer group, more so today than ever.

We talked about it earlier in the credit card conversation a bit, right? Credit is constricted for a whole host of reasons. It was already constricted. I know that may be hard to believe. It may feel like everyone was awash in credit, but there was a segment of our society that had trouble getting credit before, even before in the go-go days.

As the dynamics of the financial services industry have changed, there became a vacuum in terms of the availability of the small-dollar, short-term credit products, and in came the payday lenders. They came for a reason -- because there was no one filling that gap. I think it really behooves us to think about what we can do to make sure that we are encouraging more innovation in this space at a time when innovation, frankly, is a little bit of a dirty word.

To build on what Andy was saying, at the same time that we are providing very strong guidance around products like RALs, we have to be, I think, extremely careful about the language that we use in guiding banks. Because as soon as you say, banks should not be involved in payday lending either directly or indirectly, unless it is extremely well-defined, and unless there are other encouragements to do what we would consider responsible lending, it will drive all banks out of the market, which I think was already a problem before.

We're going to end up with the same problem we had around the bank discontinuance issue, where we gave very strong guidance to banks around how to work with money services businesses (MSBs) and they took that to mean, well, I'm not sure I want to be in the position of having to regulate my MSB partners, and so I'm just not going to work with them anymore.

You can't reel that back in, as we have now seen. In fact, there were just hearings about this a couple of weeks ago. We are still dealing with this issue two and three years later, and I really worry that the same thing might happen here.

I think that this body is a really great group to start to talk about some of the tradeoffs, as you think about how to structure and design these products. This is not easy. The economics of these products are quite tough, particularly for banks. There are a lot of tradeoffs between how you underwrite the product, what the term of the loan is, what the distribution channels are, cost of funds and capital requirements, credit risk.

I think that it requires thoughtful and deliberate conversation, but I think that this group is an excellent forum for trying to find some consensus around what we all might agree on, as opposed to having sort of shouting matches about what APR is fair and what APR is not fair.

I think there are a few things that the Fed can do, in particular, to encourage innovation in this regard. I'll go back to what I said earlier – be really careful about your guidance and language as you are thinking about reining in certain kinds of practices, so that it doesn't kill the market entirely.

I would also strongly encourage you to revisit APR as a standard for short-term loans. Your own research has shown that this is not a very useful standard for consumers as they are shopping for various kinds of products. Our research has shown the same thing. It makes for great sound bites, particularly in Washington and the kind of culture we live in today, but it is not remotely useful for consumers who are trying to compare between a $200 loan that they are going to take out for two months long. I would really encourage you to show some leadership on that issue.

The third thing is to clarify the capital requirements around holding these kinds of loans. We are hearing from banks that this is a real challenge, since these get counted at 100 percent towards their 25 percent Tier 1 capital ratios, and that even though most banks wouldn't even come close to that, given how small these loans are, that in this moment where we are being extremely careful and cautious about risk and about capital levels, that these portfolios are being called into question. So that's another place where we can, I think, provide encouragement and clarity. We certainly want people to hold the right amount of capital against the risk. But I also think we don't want to make it so difficult that folks just say it's not worth it.

Then I think the last thing is to play a leadership role that you always do around facilitating a dialogue about what constitutes a responsible and profitable small-dollar loan. I think the Fed, more than almost any other, is really at an excellent position to elevate the dialogue and to ensure that all parties are really participating.

MR. RHEIN: Saurabh, you started to bring up the FDIC small-dollar loan program.

MR. NARAIN: Thank you, Kevin. Clearly, in the spirit of finding alternatives to the RAL, the FDIC's pilot that was started a couple of years back on the small-dollar loan program is instructive. When I read the study, it was interesting for me to think about two different aspects of it.

Most banks in the case study said they were comfortable, from a pricing perspective, to have interest rates between 15 percent and 24 percent and still be profitable. So in some senses, having an APR cap of 36 percent seems somewhat reasonable. Why would we want to go to a higher level is something to be studied. From my perspective, putting that kind of a cap would be very useful.

On the other hand, the number of small-dollar loans originated by these banks is only 15,000. That's tiny in a one-year time horizon.

I would encourage ourselves and the Fed and other regulators to dig deeper into these case studies. There are three CDFI banks. There is a bank, Amarillo National Bank, that has been offering this product for about 100 years. And then there is Wilmington Trust, which is offering this thing in collaboration with nonprofits.

To think about small-dollar loan alternatives on three counts -- structure, term, maturity, et cetera, to pricing, to the cap of 36 percent -- and thinking about loss mitigation such that the capital costs can be reduced. The Wilmington Trust example is kind of interesting. They have routed the small-dollar loans through the nonprofit affiliates.

MR. RHEIN: John, did you want to give a comment? Citi was in this business and got out.

MR. CAREY: Well, we were in the unsecured, closed-end or revolving loan, not card. It is very difficult. You've got reputation risks that, if you don't price the thing appropriately, you've got those kinds of challenges.

You have got profitability challenges if it doesn't meet certain hurdles. The CDFI issue about working with local partners in those communities is potentially a solution set. But through sort of mainstream banking, I don't think there is an easy answer to it.

When you think about reputation risk, a lot of people really don't distinguish between subprime and predatory lending. So if you don't want your brand dragged through the mud, you just get out.

But that's not serving the need, and then what ends up happening is all the -- we start talking about all the other products. That's really the dilemma that I think institutions are trying to work through, recognizing that there is a need. But we had a product in a good economic environment, and it really didn't hit the return hurdle. In a bad environment, it is a disaster. So you struggle and say, well, we learned that lesson. And we have to move on to something else.

MR. RHEIN: Jennifer and then Dory.

MS. TESCHER: I want to respond to Saurabh, and I think there were a few other comments about this earlier.

I just in general think that price caps are not going to solve this problem. I think the experience that we have seen when states have tried to rein in payday lending by installing a price gap -- forget about folks attempting to find a work-around. The fact is it drives prices to the cap. It doesn't encourage price competition to lower prices. People go to what the cap is, which is, I don't think, the result that we want ultimately.

I also think that, to build on what Saurabh was saying about partnerships, we need to think more broadly about what banks' role is here. Absolutely for some banks, particularly like the ones in the FDIC pilot, the bank as the front door for the consumer, providing these products directly, seems to work. Whether those economics are really going to work for the Citis of the world or the Wells Fargos or other mega-banks is really not quite clear, but that doesn't mean that there isn't a role for them to play in providing capital as a wholesaler to other small providers.

So the conversation we were just having about how it is horrible that banks are essentially funding RALs, we shouldn't throw out the model, right? There is a responsible way for banks to provide credit to lenders and other providers who are in the community, have better sort of face time, if you will, location, presence. Consumers may feel more comfortable with them. I don't think that model should be dead. I don't think we should throw it away. I think we just need to make sure that it is implemented in a way that is going to be ultimately of benefit to the consumer.

MR. RHEIN: Okay. A couple more comments. Dory?

MS. RAND: Yes. I just wanted to follow up on Saurabh's comments and clarify. I think you might have said that the FDIC pilot program was as an alternative to RALs. But it is as an alternative to high-cost payday loans.

MR. NARAIN: Yes.

MS. RAND: I definitely support encouraging banks to be involved in alternative, small-dollar loan programs that are affordable and sustainable. I don't think there is a need for a RAL of any kind. I don't think there is a responsible RAL. They are an unnecessary waste.

MS. TESCHER: And my comments were not about RALs either, just to clarify.

MS. RAND: Okay.

MR. RHEIN: It's about small-dollar credit in general.

MS. TESCHER: Yes, exactly.

MR. RHEIN: Mike, did you want to?

MR. GRIFFIN: Yes. Our bank has very cautiously evaluated doing some sort of a small-dollar loan, primarily focused on existing clients who have direct deposits. As we have looked at it and as we are actually looking to roll it out later this year, we have really focused more on the length of the loan.

I go back to my affordable housing days when, if somebody doesn't have their rent this month, they don't have double their rent in another month. They can't do both. If we are lending somebody half their paycheck today, they don't have half their paycheck again in two weeks plus their living expenses. You are putting people on a system that is basically the same impact as a payday loan. You are causing them to renew that loan, pay the fees again, and go forward.

So we have really looked at how do we extend that time frame out over a 60-day period? We would make the loan, they would pay a fee, we charge an 18 percent interest rate, and then that loan gets paid from their direct deposits over those 60 days. That's really what we are focused on.

I say 18 percent, and I think what we are looking at now is a 6 percent fee. When you add that up as an APR, to my horror, it is about 90 percent. I guess I would agree with Jennifer, I don't think that APR is a correct measure when you get into a small-dollar, short-term loan. It just exaggerates what the cost is. Other people may disagree with that.

MR. RHEIN: Yes, Mike?

MR. CALHOUN: I wanted to follow up on your comments because I think we have had several experiments with this. For example, North Carolina allowed payday lending starting in the mid '90s. We were one of the early states and then in 2001 decided not to extend it.

Payday lending was supposed to be once in a blue moon. Virtually all the payday lending statutes, when they started out and most of them today, have an absolute prohibition on "rollovers," because they weren't designed, and they have disclaimers in the store -- this is not designed for long-term credit.

Then the inflection point happened when a number of regulators, including North Carolina, ruled that a back-to-back transaction was not a rollover, so that you could come in and they can afford to pay off the loan because they just got paid. But like you said, if they pay off the loan, they then clearly don't have money to pay their absolute minimum living expenses, so they take out another immediate transaction.

To just sort of reflect how the industry has evolved, about a year and a half ago now, Virginia passed a limit, saying all right, you can do 10 payday loans per year per borrower. And the industry withdrew from making standard payday loans in Virginia because their business model absolutely could not work at 10 loans per borrower per year.

They make over half their income, over half their revenues from people with more than 15 loans a year. Your point, I think, is a real key one. We went through this whole experiment, not just in North Carolina but the whole country, at the beginning of the 20th century with factories developing. You had salary loans where people actually got the right to go to your employer and collect your paycheck. And that led to a foundation, I think it's the Sloan Foundation, intervened because it caused chaos, because families ended up out on the street, because, again, folks who didn't have money to pay their essential bills got put out on the street. Serious social costs. The main reform was exactly what Mike was talking about, was the real key -- it set interest rates at a fairly high level, but affordable payments.

These folks, they need credit. They don't need short-term credit, almost overwhelmingly. And that's why we have supported, for example, the FDIC approach of saying, if you're going to have very high-cost, very short-term loans, put a limit on it. The FDIC limit that they imposed was Powell rather than Sheila Bair, Sheila's predecessor. They can't put people in these short rollover loans more than 90 days a year. And overnight, state banks that were doing the rent-a-charter for payday lending got out, because the business model wouldn't work limiting borrowers to 90 days a year, a fourth of the year, in payday lending.

So, our experience has been exactly what Mike's has been. But we need to probably move on to another section of our discussion, unless there are one or two more.

MR. RHEIN: Yes, why don't we just wrap up? Ron and I had conversation, and I don't know if it got in with the group, but just a thought on how do you start to address -- you've got significant operational costs that John mentioned, you have credit losses that go along with this. So what could you do in a structure to try to create some partnerships where you might be able to address one of those elements that might get banks more into this game?

Do you want to talk about your involvement?

MR. PHILLIPS: Yes, thank you. Just from the conversation yesterday, it just occurred to me around this that there is this innovative, but not widespread product being managed and handled by many nonprofits in this country called Individual Development Accounts. I think many of us are familiar with those.

The rationale behind that is very much to make investments in families and individuals, to get them into the credit and banking system, those who are not in the system, those who are under-banked, those who are de-banked perhaps, those trying to get back in.

These are matched savings accounts. The government puts money in and matches the savings that a family or individual will put into that account. The account is typically in a bank or credit union. There are restrictions on how the money can be accessed. The funds can be used for education, for example, for medical or health issues. I think another use is actually for small business, if you are self-employed. And these are all protected by the IRS in terms of the values and reasons or ways you can take those monies out.

Now, if there is a real interest in building assets among families and individuals, which is what this IDA program is about, there may be ways to structure the deposit of those funds, which is then sponsored by the banks and credit unions, as I have said, to allow for small loans for certain purposes.

So there is a ready product there. It would have to be looked at more closely in terms of the current regulations and the capitalization of the program, but it is a very interesting product out there. Thank you.

MR. RHEIN: Great. Thank you. Mike, back to you.

MR. CALHOUN: At this point in the program, we have an open session where people can raise comments that they haven't had a chance to raise, either due to time limitations or on a topic that didn't come up before. We have about five people who signed up, six, I think, actually who signed up already, so if I can recognize them and then if we have time, maybe reach one or two others. We need to stick pretty closely to finishing up at 12:30, so we need to keep things moving.

Let me recognize first, Shanna, you had some fair lending concerns that we haven't heard yet today.

MS. SMITH: When you listen to everyone talking about the foreclosure issues, loan modifications, REO, marketing, the maintenance of REO properties -- people brought up the impact on homeowners when there are vacancies in the neighborhoods and now insurance companies are either not insuring or really having high premiums when there are high vacancy rates. It reminds me that last meeting we had Carol Evans from the fair housing/fair lending division speak to us about the GAO report and talked to us about the Fair Housing Act violations and ramifications on these issues.

What I'm hoping is that perhaps on the Housing and Community Development Committee we can have Carol or someone from her office serve with us on that particular committee and then report either here or in our Wednesday meetings about what they are learning, looking at HAMP when they get the data. Is there disparate treatment, disparate impact issues being raised based on race, religion, the federally protected classes? If it is, telling the groups here who have direct contacts with consumers what those violations look like so that they can talk to the counseling groups and make referrals to the Fed or to the Department of Justice.

I would like to see a report from the Fed at these meetings about how many referrals have been made to the Department of Justice based on any fair lending issues that have been uncovered with the banks that are regulated.

And finally, one of the sister regulators is doing testing. The GAO report recommended match-pair testing and other testing of lenders and on the RALs. One of your sister agencies, I understand, is doing that testing. I think it can show both deceptive practices, but as has been pointed out by a number of people, there are also race and ethnic issues that arise from these particular practices. Thank you.

MR. CALHOUN: Kirsten, you had some concerns about reverse mortgages that I think echoed a lot of people's comments, if you could share those?

MS. KEEFE: Yes. Yesterday we had a really great conversation, I think, about reverse mortgages. I stated then and I'll state again, I was certainly accused of being overly dramatic about sending warning signs, especially to friends and family, about the subprime mortgage lending crisis. In hindsight, I don't think I was overly dramatic enough.

I think that we need to be dramatic about the potential for similar abuses in the reverse mortgage lending world. We are at the beginning of what some predict to be a pretty healthy market. It is already acknowledged that these are very complex financial products, as well as the fact that they are being sold to an inherently more vulnerable and trusting population. So I think we need to be much more proactive at the upstart of this process to make sure that these loans are suitable, to make sure to the extent that lenders are going to rely on third-party brokers, that the conflicts of interest for the brokers that are now obvious in hindsight while looking at the subprime disaster are gotten rid of and the sale of reverse mortgages is somehow regulated.

There are predictions that this could be a new area of securitization and a boom for securitization. I think we need tight controls in watching what is going on with the securitization of these products.

And then I just want to warn against a lot of the materials, wonderful materials that we were provided by the Federal Reserve to prepare, really talked about relying on counselors to a great extent to send homeowners to before they get certainly a HECM (home equity conversion mortgage) and potentially extending that requirement into the proprietary reverse mortgage market, which I think is always a good thing. I am the biggest cheerleader of housing counselors, outside of actually being one myself, but I don't think that we can really rely on counselors to get rid of the scams. If we are spending so much time to send people to counselors to educate themselves to prevent them from getting into scams, why don't we just do what we can to get rid of the scams to head it off?

I would love to see it on a more formal agenda in the future. I'm sure we will be discussing it more so.

MR. CALHOUN: And I don't know if you want to address quickly the issue about escrows and taxes and insurance that has been such a problem with the reverse mortgages?

MS. KEEFE: Right. That was a really big part of our discussion yesterday, and I don't think we really came to any conclusions. I certainly haven't come to any conclusions in my mind.

But one significant way a homeowner can default on a reverse mortgage is by not paying their taxes and insurance. There are a lot of concerns. If you escrow up-front or set aside a certain amount for taxes up-front, does that get people out of the habit of paying their taxes? When that reserve ends, are they not going to be paying their taxes?

Do you require escrowing? I think that that could be problematic for some of the smaller banks. There are just a lot of issues and concerns about the escrowing. I think about it a lot from New York because our property taxes are so high. In a way, I think that a reverse mortgage could be a way to keep people in their houses just to maintain their tax payments. There are a lot of questions that need to be addressed.

MR. CALHOUN: Thank you. Saurabh, you had some concerns about CDFI community banks and some of the challenges they are facing with accounting rules and other lending obstacles?

MR. NARAIN: Thank you, Mike. This is in the spirit of sort of keeping credit in the system. As some of the credit gets dried up, the regulators and the Administration have been pursuing small business credit, personal credit and credit to businesses in local communities to revive the economy.

CDFI banks and other community banks have been active lenders, despite the perfect storm of the recession that they are facing. So far institutions have grown 10, 20 percent. However, they continue to suffer from some of the unintended consequences of the accounting rules and how the regulators have pursued valuing of loans.

In theory, if the collateral value of the loan is actually lower than the value of the collateral when the loan was given, then the loan has to be impaired. To go to Cleveland, where a lot of the collateral is now worth $10,000 or less, we immediately start collapsing the value of the loans, causing a significant decline in the solvency in the capital ratios of the bank.

However, the regulators have also made a point of the fact that if the loans are cash-flowing, if they are current, then that has to be a significant input into impairing the loans. That is actually not getting done at the ground level. As a result, a number of smaller banks who got less margin for error are at significant risk of stopping lending, something that they have been active during the last 12 to 18 months.

So I thought I would bring it up in front of the regulators. A word of caution and a word of oversight on this issue is important. Thank you.

MR. CALHOUN: Yes? There are a couple more, but I think we will still have time. Andy and Kathleen both have comments on the role of the Fed in consumer protection. Do you want to start, Andy?

MR. NAVARRETE: Sure. I apologize to Mike as I told him I was going to choose either one of two topics and actually I'm choosing the other topic, since I knew we were going to talk about the consumer protection and, of course, I would urge the Fed to continue to make the case for keeping consumer protection.

But what I want to talk about a little bit is how do we capture the richness of this dialogue in a more external environment? I'm always struck by the actual level of consensus among this group on a number of different issues. For years, consumer protection or the concept of consumer protection was largely defined as an access-to-credit issue. It was about CRA. It was about how do we take a very confined product and make that more widely available to consumers?

We have had a lot of success over the years actually achieving some of those objectives. I talked about penetration of credit card rates. We could talk about the same thing in the context of homeownership rates, et cetera. Unequivocally, that has been a good thing.

But in recent years, that dialogue has shifted fairly dramatically. Now it is much more about policing the terms of certain credit products or, in the case of many conversations today, eliminating products entirely -- things like RALs, reverse mortgages, other products, certain kinds of subprime mortgages, et cetera. Inside this room, we talk about that, I think, as unequivocally a good thing, that this is a positive trend. It is bringing more discipline to the industry, more protection of consumers.

But then when the industry adjusts to some of these changing dynamics, and the two most salient examples perhaps with more emphasis on up-front terms in credit cards and the repricings that took place in 2009. You are going to see a similar phenomenon, I think, with overdraft as overdraft fees are largely weeded out of the system. You will see a return of probably fees, checking products and things that many of us grew up with.

When we talk here, we tend to agree that this is a good thing. We tend to be very explicit about the objectives of the legislation or regulatory efforts. When we get out of this room, the dialogue tends to shift towards banks are exploiting loopholes by adding new terms on credit cards or raising APRs or adding annual fees or by adding fees to different kinds of deposit accounts.

I would like to see us more unified externally in talking about what our explicit short-term and long-term objectives are in the credit space to bring greater discipline, transparency, but to own up that that has certain consequences for consumers and that that spreads the cost of credit or deposit products much more broadly than risk-based pricing drove us to in the last decade.

MR. CALHOUN: Kathleen?

MS. ENGEL: Okay. I'm not going to respond to Andy because I know that this is not a discussion. It's a time for comments, which probably you are all pleased about.

Let me start by just saying that I am incredibly impressed by the great work that is coming from the staff these days. Just how many regulations, how many pages alone of regulations, never mind all the different topics of regulation, the new work around with the media and trying to connect with consumers, it's all really exciting and impressive. It seems like the staff's output has quadrupled or something, and I think it is the same staff we see at every meeting. So it's really impressive. Nothing that I'm about to say has anything to do with the work of the staff.

I think it was about a year ago Chairman Bernanke informally asked the CAC – and this was during the initial debates about where the consumer protection authority should be housed -- he invited us to give him some feedback about how the Fed might better reflect its consumer protection mission. And we actually had an interesting discussion.

Since that time, CAC members and a number of different members on a number of different occasions have tried to get this issue on the agenda of CAC meetings. And by issue, I mean the question, where should the consumer protection authority be housed and, if it is retained by the Fed, how could the Fed enhance its consumer protection image with consumers in the world and all of that? It's not just a question of image. It's also how the Fed can advance its consumer protection agenda.

For me, this reluctance to engage in a conversation with CAC about these issues has led me to oppose the consumer protection authority remaining at the Fed. I, along with a number of current and former CAC members, have recently written to Senator Dodd expressing our views that there should be an independent CFPA. I think it is important, given that this institution, the CAC, is precisely the place where we should be having vigorous discussion about where the authority should be housed and how it should be exercised, I find it problematic that we haven't had that opportunity here.

MR. CALHOUN: I think we have had some opportunities there. We've got to go real quickly, so like a minute each for you and then we have got some housekeeping.

MR. DIAZ: Super quick. Following up on Mary's comments, the Fed can serve an indispensable role in facilitating and allowing the dialogue to rise about how shall we reconstruct a liquid and deep secondary market for mortgage instruments. It is in a unique and inimitable role in allowing those downstream from its member banks and upstream, all the stakeholders, in addition to other regulators to think through how shall we reconstruct a market that provides a trust for folks who are in far-off lands and finding instruments in which they can invest and trust that they will get an expected return, as well as people who want to participate in the market that wish to remain in the home sustainably.

The Fed has a wonderful role to call the participants together and enable this dialogue to take place. Right now, we are all focused on the issue of policing and so, in a sense, we are rearranging the deck chairs on the Titanic, but nobody is looking at where the ship is heading.

And the ship is heading in a very destructive pace right now, which is we don't have a market and I don't see one coming back unless someone focuses on the issue of how shall we bring this back. The Fed has just a wonderful reputation and resources to look at this from a very constructive means and bring it to solution in a rather quick process, whether it might be by developing pilots or developing different models that it can look at and how we can construct this and bring all the players together. Thank you.

MR. CALHOUN: Mary?

MS. TINGERTHAL: Very quickly. I was struck yesterday by a principle I would like to leave with you and that is for faster and more frequent monitoring of industry practices as they change. I was struck both with the points that Andy made, which is when you have a major change in rules, practices will change and they will change very quickly. We won't know until we look at them which ones are evolving in more or less positive directions and which ones are evolving in what we might think are more negative directions.

The same thing was brought to mind in Kirsten's discussion about reverse mortgages, that this is an emerging product. We think the product is going to grow, but we need to monitor it quickly and up-front in order to stave off the bad practices that we may see emerge in a market that could have abuse.

I guess what I just would like to say is that in a world where a YouTube video can go viral in 24 hours, the normal two-year time frame for reviewing regulations and reporting back to the Board probably is just a little too long.

MR. CALHOUN: Let me add one comment and then go through some housekeeping.

There were a number of issues that we discussed in our meetings yesterday, the changes to rescission, the Low Income Housing Tax Credit, New Markets Tax Credit situation, and one was clarifications on the overdraft rules. That's a rule that you have got coming up soon. I would like to put in just a quick pitch there that the issue is, for people who don't opt in, they are still subject to some overdraft fees on ATM transactions and on ACH transactions. Excuse me, not ATM, on their checks and their --

So you have two categories, fee-permissible and non-fee-permissible. They will opt out of the one-time debit and the ATM. They don't have a choice, they are included on the check and the ACH.

So the question gets complicated, and the main reason for clarification is how do you apply the different fee rules and prohibitions when you have a mix of those charges coming in? The rules get very complex. There are three different kinds of overdraft fees. There are tiered fees, depending on how much you go over. There are initial fees, and then there are sustained fees.

For the tiered fees, we think you adopted the right rule which said, essentially, ignore the non-fee eligible transaction. How much did the fee-eligible transaction kick you further in? For example, even if you were in the negative $10 on the other transactions, if the other one kicks you in $20, that's what you count. You don't say you are already $10 and it makes $30.

For the other transactions, it is a more legalistic whole or part caused by the non-fee transaction. It gets very complex, and it will be totally impenetrable for consumers. Our suggestion is you follow what you did with credit cards under the Card Act and just say, do it in the manner most favorable to the consumer. It is very similar to applying credit card payments to different balance accounts with different interest rates -- your zero-interest rate balance, your other percentage rate. When you get a payment in, how do you allocate it? Ultimately, it came out allocated in a simple way -- one rule, most favorable.

Let me jump though, because we do need to get out of here, to just comment on housekeeping.

First of all, the comment about outreach, we had a presentation on your new credit card website, which we all thought was a tremendous idea, and there were many suggestions to even push more aggressively to be more proactive and more hip in some ways, if you will, to people who aren't already thinking about checking bankrate.com and the other websites. Those folks are probably the safer customers. How do you reach out to the other ones? We think it is a very positive development and the staff had a really good start.

We also talked about additional ways that the CAC could assist the Fed in its consumer protection program. For example, in the past, the CAC has written reports on various items with recommendations to the Fed. We are looking at, with Governor Duke's encouragement, which we thank her for, looking at those options in the future.

You have also announced HMDA hearings, and we are happy to assist in any way that we can with those hearings.

Finally, I just want to thank you, Governor Duke, for your leadership and your participation today as well as you, Governor Tarullo. I don't know if you all have any closing comments or, Sandy, do you have any closing comments? Thanks again, I just echo the words to the staff -- Jennifer, Shalyce, Joseph, and then all the staff who made the presentations. Everyone here is just repeatedly impressed with the high quality of their work.

GOVERNOR DUKE: Mike, if I could just very briefly, I would just like to express the appreciation of the Board for the time and the energy and the good work that you have put into this. The information that we get out of it is incredibly valuable, so thank you.

MR. CALHOUN: Thanks, everyone. We will have our lunch just down the hall on the left. At the desk out front, there will be arrangements if you need to ship any materials.

(Whereupon, the meeting was concluded at 12:34 p.m.)