TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING
THURSDAY
MARCH 13, 2003

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

Members present:
Ronald Reiter, Chair
Agnes Bundy Scanlan, Vice Chair
Anthony Abbate
Janie Barrera
Kenneth P. Bordelon
Susan Bredehoft
Constance Chamberlin
Robin Coffey
Dan Dixon
Thomas FitzGibbon
James Garner
Larry Hawkins
Earl Jarolimek
W. James King
Patrick Liddy
Ruhi Maker
Oscar Marquis
Patricia McCoy
Elsie Meeks
Mark Pinsky
Elizabeth Renuart
Debra S. Reyes
Benson Roberts
Benjamin Robinson III
Diane Thompson
Hubert Van Tol
Clint Walker

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

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P-R-O-C-E-E-D-I-N-G-S

(9:00 a.m.)

CHAIRMAN REITER: Please take your seats. Good morning. Welcome to the March meeting of the Consumer Advisory Council to the Federal Reserve Board.

I would like to express, first of all, the fact that we are very privileged to have with us Governor Gramlich and Governor Bernanke. Thank you very much for being here with us.

I would like to also welcome to the Council some new members, and I would like to just mention your names: Susan Bredehoft.

MS. BREDEHOFT: Here I am.

CHAIRMAN REITER: Dan Dixon, Jim Garner, Jim King, Elsie Meeks, Mark Pinsky, Benjamin Robinson, Diane Thompson, Clint Walker. Very good. Welcome to the new members.

All right. We would like to -- I would just like to make one brief announcement, and that is that at 11:00 o'clock this morning there will be a break, and there will be a group photograph taken of the Council members. So we should assemble for that at the 11:00 o'clock break.

Moving on, if we can, I would like to turn the meeting over to Oscar to discuss the check bounce protection issues.

MR. MARQUIS: Thank you very much, Ron. The committee yesterday discussed check bounce protection, which is a -- Traditionally, banks have provided coverage of NSF checks for their favorite customers, for their better customers, but of late banks -- or many banks have started to systematize the process, systematize the decisionmaking process as to which checks to cover and which they shouldn't cover.

They have standardized the decisionmaking process, and some banks are advertising it and promoting it as a reason to open an account with the bank. For example: Open a checking account with us, and don't worry about bounced checks; we'll take care of it.

This has raised a number of issues that we had to discuss, but what these systems tend to have in common are that they are applied to a class of account as opposed to a type of customer. Consumers or customers don't apply for the program. It is provided to them automatically. So, in effect, there is no written contract.

The eligibility criteria usually is have an account, have an open account that is --

with regular deposits, no defaults, and it has to be brought back to a positive balance fairly quickly. The banks agree to pay up to an aggregate amount for the bounced check, in the $300 to $500 range.

The fee charged is usually equal to or a little more than the NSF fee. It is accessible by checking account or by check or ATM, and whether or not the check is covered is really left to discretion of the bank, as I said before. There is no written agreement.

So we had a fairly healthy discussion about whether or not this kind of bank program should be covered by Truth in Lending or what other kinds of disclosure should be made.

I think we can start the discussion with Anthony. Anthony had some good comments.

MR. ABBATE: Thank you. Allowing customers to overdraw their accounts enables them to avoid the embarrassment of a returned item and the associated fees from the bank, the merchant, and any others in the check collection process.

Overdrafts should not be associated -- Excuse me. Overdrafts should not be associated as an extension of credit. The bank doesn't go through an underwriting process to determine the creditworthiness of the account. If the account is in a temporary negative balance, there is a fee imposed for the accommodation to pay the check, which is to offset the cost of handling and risk.

This is a tremendous service for people, since they don't open their statements, let alone reconcile them. In my company, we operate an automated inquiry voice response unit. With 28,000 households, there were 516,000 inquiries about account balances, which goes to reinforce my assertion that many consumers don't keep running balances, and in recent memory I haven't received any complaints from customers for paying a charge and a fee for an overdraft.

As I see it, there are three separate and distinct programs: The traditional where, on an *ad hoc* basis, a decision is made to pay or return a check; a decision plan where banks utilize the capabilities of their data processing systems to identify customers by tenure and loan relationship to be automatically accommodated without further analysis, allowing all to be treated equally without discrimination. Then there are those programs that are provided by third-party vendors for a fee to those banks lacking the data processing sophistication, with the promise of enhanced fee income and a fee for the results of that program.

The third-party programs are ones that, in my opinion, require the attention of regulation, due to the manner in which they are being marketed to the consumer, to the extent that the banking industry is being unfairly criticized.

The regulators have the authority through the Truth in Advertising laws and other tools to enforce and rein in these deceptive practices. To this end, I would suggest that attention be focused on third-party vendor programs and not the industry as a whole.

CHAIRMAN REITER: Susan, did you --

MS. BREDEHOFT: My comment on the programs are that new products and services evolve constantly in our industry, and these programs appear to provide benefits to consumers. Consumers use them. So there appears to be a need. Yet I understand that there is concern about the fairness and the cost of some of these programs.

My point is I don't like to see programs and services stifled. I would like to see us work together on the programs to understand them and to come up with a design that everyone is comfortable with, that is safe and sound and fair to all people.

CHAIRMAN REITER: Elizabeth, did you have anything to counter those two positive comments?

MS. RENUART: Of course, I did. Just a little background, and that is that the Truth in Lending Act statute itself does not address whether a nonsufficient funds leads to a finance charge or not. That has only been addressed by regulation and by official staff commentary.

So if you looked at just the statute, it looks like these would be considered finance charges, which would render them credit. So, really, this is an issue that the Governors as well as the staff can deal with, given the fact that right now what the situation is, is quite different from what it was years ago in Regulation Z and its presence upon many official staff commentary were enacted, the reason being at that time you either had assigned written agreements for an overdrawn credit account, and that was only given to certain customers after a credit check was performed, etcetera. Those were for the best customers rather than for the less than best customers.

In addition, the banks would, quite nicely for customers on an *ad hoc* basis and a discretionary basis, decide in a particular instance whether or not to honor a check, even if there were insufficient funds in the account, and either charge or not charge a fee for it. They could easily not charge a fee and do that for whichever customers they decided.

Over the last few years, the situation has changed, and now there is this -- Well, let me backtrack. So Regulation Z took into account those two situations.

So that, yes, it is a finance charge and, therefore, it is credit and subject to Truth in Lending disclosures if it is an official line of credit and there is a written agreement, and that if it is discretionary and on an *ad hoc* basis, then those items could be paid, and a nonsufficient fund fee could be charged. However, the products that we have been addressing and looking at and reading about yesterday at our committee meeting are quite different.

They are -- How they have been crafted is to fly under this Truth in Lending radar screen, because the radar screen was created at a time when these products didn't exist. Now they are being marketed quite differently. Consumers are being told, you know, peace of mind, we will be paying your checks for you.

They are encouraged to use ATM machines, not just write checks but ATM machines, or whatever other form of withdrawal from their accounts, and some are being advertised as you can live from payday to payday. That's similar to a payday loan, and we know that those products are very expensive, if not right out abusive. There has been discussions in the Council over the last couple of years about those products.

So these products, this new line, is what is different from the old system, and it would be quite easy to decide that the Board and the staff could decide that these are credit because, in fact, the payment is not immediate. If people don't come in and pay immediately, the nonsufficient fee and, in some cases, some banks also charge a per diem fee on top of that. Those could all easily be considered finance charges.

In fact, as I mentioned, the statute does not exclude them at the moment. So they would be considered a finance charge and, therefore, these are credit products, because people have gotten cash. A debt has been deferred, and it is due within up to 30 days by the terms of these agreements.

While not in writing, because again vendors are trying to slide under the Truth in Lending radar screen, there's writing, because there's advertisements and there's written materials. In fact, you can have an oral contract for a loan. It doesn't have to be in writing by law except for statute of frauds issues. You can have an oral debt.

So in my opinion, these are loans, should be more strictly regulated, and I'm not suggesting that they should be treated as closed-end credit. Then the question becomes, if they are loans and these are finance charges, what do we do? What's the next step for disclosure?

In my opinion, I think they operate more like open-ended credit, because on the closed-end side, I understand it is possible for a creditor to give the federal box for a closed-end transaction. When you have written a check to a merchant, the creditor is not there to give that to you, and that's the time that the extension of credit would occur.

So you could easily treat it like an open-end where you would get -- where the initial advertisement about this product could be regulated as initial disclosures, as they are for credit cards where at the initial disclosure you get when the account is opened, you would get certain disclosures, and I have particular ideas about how those could work, which would not be based on the actual amounts or actual times but could be a chart to show that, based on these fees, if you pay back within a certain number of days and you are at a certain amount, here's what the APR would be.

So it could be an example. Then they would have the right to billing statements. So those are all things that banks are used to doing anyway for open-ended transactions.

MR. MARQUIS: Ed.

CHAIRMAN REITER: Oscar, excuse me a second before going forward. Governor Bies has joined us, and I wanted to welcome you.

GOVERNOR BIES: Thank you. I apologize for being late.

CHAIRMAN REITER: Thank you, Oscar. Go ahead.

MS. McCOY: Oscar, thank you. My concern here is that we essentially have a two-tiered credit system. We have a regular line of credit with a transparent APR for relatively affluent customers, and then we have the bounced check system in which the fees are denominated as lump sums rather than as APRs and do not have the same transparency.

Furthermore, the fees are invariant to the size of the bounced check. So that you might get a $35 fee for a bounced $250 check, but two $35 fees for two bounced $10 checks. Of course, the effect of APR in those two situations is very, very different.

All I would ask here is that we have one other disclosure, which is the effective APR. We are not asking to stop the program. We just want to make it transparent.

MR. MARQUIS: Agnes.

MS. SCANLAN: Thank you. Given our discussion yesterday and the information that the staff provided, I do think that there needs to be further review on this subject. However, two points. One, financial institutions are in the business of providing services to our customers, and our customers do say that having the transaction go through at the cost of a one-time fee is, in many cases, far better than having a check returned or, say, missing a mortgage payment or a car payment.

People do believe that, when the chips are down, the rate means little to them, not that it should be high, but it is the availability of credit. That's what they want, the availability of credit. So I do believe that customers need some sort of an overdraft protection. However, one thing we didn't talk about yesterday, which is something that should be brought into the equation, is consumer education.

The Chicago Fed in their January newsletter talked about some of the work that they are doing in Chicago, working with the libraries, the public schools, the government agencies, community organizations, as well as the media, to bring awareness of the range of products and services that are offered by financial institutions in order to help consumers understand how they can use the products and services.

So I think, one, there does need to be further review on this situation, but one thing to add to the equation is more consumer education and awareness about products and services and how to manage their finances.

MR. MARQUIS: Thank you. Earl?

MR. JAROLIMEK: Thank you, Oscar. My comments are probably based more on observation. Our company doesn't offer the program. But I think what I might do is just suggest or urge the Board to consider somewhat of a "walk before you run" approach, and that might speak to Agnes' further review recommendation.

In hearing the comments of some of the industry representatives here, it doesn't seem like the level of customer complaints on this product is high, if evident at all, and I suspect many customers would be very unhappy without the service, if it were taken away.

The subject of disclosure continues to come up, and my observation is there's really three levels of disclosure in place right now. There is the Truth in Savings disclosure where all the fees associated with a deposit account are clearly disclosed to the customer per that regulation's requirements.

There is a deposit account agreement that every financial institution I am familiar with also puts in front of the consumer where the consumer agrees to the terms and conditions of the account, including the fees and other characteristics of the account.

The third thing I have noticed in observation is almost everyone who is offering the program, no matter what the format, is communicating with some form of a letter to the consumer advising them that they are enrolled in the program, and they do take some different forms.

So one proposal might be to consider perhaps standardizing in some fashion that letter. However, I wouldn't encourage anything in the way of an APR. I think I agree with Elizabeth. This speaks more to an open-end credit product than it does a closed end, and Regulation Z, even on open-end products, because of their revolving nature and the transactional nature, does not attempt to calculate an APR.

It really -- If you look at an open-end product, the rate is the APR, and it is because of those characteristics. With all the transactions going on virtually daily, it is virtually impossible to come up with an APR, as you can in closed-end credit. I think it would be very confusing and misleading to the customer if one were to attempt to do that.

So the APR, in my opinion, doesn't seem to have much value. Disclosure, perhaps, in the letter that made it very clear what the fees were in some standardized fashion might be a compromise.

MR. MARQUIS: Thank you. Larry?

MR. HAWKINS: I have some concerns about the fact that, if you do some of the other things and you -- all your Truth in Lending disclosure and APRs, that it almost looks like you are obliged to always pay the items, because essentially you have put some kind of credit line in place, when in fact you have made it clear with some of these products that you may or may not pay an item.

So I don't know if it is truly an extension of credit in any sense of the word along those lines, even though we know historically the overdraft is always, yeah, you've loaned somebody monies, because you paid an item.

The issue and the problem seems to be the fact that it has become programmatic and systematic. Banks, I guess since the beginning of banking, have always obliged certain customers by paying their items.

It seems to be that now, because there's been a systematic and programmatic approach to this, that the concern has arisen, and we understand some of the reason why that is, if in fact these products are being advertised and encouraging people to overdraw. So I do believe that education is very, very important, but I think in terms of whatever happens, we need to make sure that we manage to keep the baby while we throw out the bath water. That is that, you know, based on what we do, I think it can cause more harm for the consumer than it can help the consumer.

Bottom line, the consumer is going to get charged for an NSF item, whether you pay the item or not. I think what needs to be taken strongly into consideration is how do we then minimize some of the other charges that the consumer may get if an item is run more than once, and essentially if the payee also is charging the consumer.

I think the goal for most banks -- Now I cannot speak for the industry who has come up to a product, a platform -- a product that they sell to banks, but I think the goal for most banks has been to essentially bring a certain class of consumer back into the banking fold, because we have lost so many of them to check cashing companies and to the payday companies.

So whatever action is taken, let's please carefully take that into consideration, that we essentially alienate or run off consumers or do more harm than good while trying to help them.

MR. MARQUIS: Ron?

CHAIRMAN REITER: Thank you, Oscar. I'm concerned about some of the deceptive marketing that goes along with some of these programs. Certainly, not every bank that offers a check bounce program is guilty of that, but there is a sufficient question regarding the manner in which these plans are marketed that goes, I think, to the question of what consumers really understand.

It's sort of the other side of the disclosure and information issue that Earl and Larry have spoken about. For example, advertisements for some of these programs suggest that the bank will pay every overdrawn item or at least every overdrawn item up to a particular amount. Let's say up to $300. But in fact, when you read the fine print, the banks reserves the right not to pay every item.

Seems to me that, if consumers are led to believe that every item will be paid and that they have some assurance that they do have this extra reservoir of cash that they can draw upon, and then that isn't the case, that there is a serious problem with marketing.

Secondly, we find with some of the programs that the statement of the existing balance in the account may be misleading. For example, some programs will, if you go to the ATM and you get a statement from the ATM as to what your balance is, your balance will include this extra $300, let's say, of check bounce protection that you have. So your account balance may be zero, but the ATM slip will show that you have a $300 balance.

People not recognizing what their balance may be, as Anthony pointed out, may very well draw on that money, believing that they have money in their account when they don't, and then incur these larger charges. So I think we have to be sure that statements of balance are very accurately indicated to people and, if there is an extra reservoir of cash available, that that may be separately indicated, but that people understand what they have.

Thirdly, there have been some allegations that some financial institutions will pay larger items and then bounce a number of the smaller checks that come through, having the effect of generating a number of NSF charges. If there are also these charges and the checks are paid and then there are per diem charges added to that, that can create an issue.

Now it can certainly be said on the other side that it might be very well better to pay the mortgage check, which is a larger check, and bounce the smaller checks for the utilities and the telephone and all of that, but nonetheless, there are charges there, and people, I don't think, understand how the program works and the fact that they can generate a number of charges as a result of having the smaller items bounce.

Lastly, with respect to per diem charge, I think it is true, as Larry pointed out, that there are NSF charges that would be imposed for a returned item, and the consumer certainly may be well benefited by having an item paid, if the consumer only has to pay that same NSF charge that would have been imposed in any event. But if there are per diem charges in addition, those need to be very clearly disclosed. Consumers need to understand what they are, and it is very difficult to escape the conclusion that Elizabeth was drawing, that especially these per diem charges are in the nature of an interest charge or finance charge imposed for the extension of credit.

MR. MARQUIS: Hubert.

MR. VAN TOL: Ron actually covered the point I wanted to cover. Several years ago, upon moving, I accidentally got into one of these accounts, and the balance was always shown as being $500 more than I actually had in the account. You know, I think of that as being an unfair and deceptive practice, and I really think that is a critical thing for people to look at.

MR. MARQUIS: Thank you. Pat?

MS. McCOY: I wanted to address the link between disclosure of the effective APR and consumer education. I do agree with Earl that it is not possible in advance to disclose an APR, but you can, after the fees have been assessed, disclose the historical APR.

That is the key information that tells the consumer this is the effect. You are having bounced checks. You are now paying an effective 400 percent APR or an effective 2000 percent APR.

It seems to me that very, very precise piece of information is the critical link in consumer education. It tells you what is the effect of your actions.

MR. MARQUIS: Thank you. Elizabeth.

MS. RENUART: Just to respond to a couple of the points that were raised. I found it interesting and helpful that Agnes indicated the need for extensions of credit. I agree with you about that. These are extensions of credit, and once that happens, once that word is used and that's what is actually going on, then Truth in Lending requires that some disclosures be made.

I'm not suggesting that the product be banned necessarily. There are some -- in some instances where people need to have or want to have their checks covered, like it's been going on in the *ad hoc* system prior to this more systematic approach, that is of benefit to the consumer. And if they are charged an NSF fee that is reasonable, that's up to the bank, but that's been a relationship between the bank and the customer that was ongoing and could be helpful to the consumer.

What I'm saying is, if it is going to be happening, it should be treated as credit, and certain disclosures should be given.

In terms of whether the disclosures can be an effective APR, you know, at the time of the initial opening of the account, if it is treated as open-ended credit, of course not, because you don't know -- Nothing has happened yet on the account until something is actually drawn on it.

In fact, if the NSF fee itself is not considered a finance charge, then the APR at that time is zero. There is no periodic rate that is applied to these transactions. So my proposal is that NSF fees be treated as finance charges, as well as any per diem charges in any systematic program.

Any *ad hoc*, discretionary program -- then, no, it would not be a finance charge, but in a systematic program such as what has been instituted where things are paid automatically -- for example, in Anthony's program, things are paid automatically up to $300 for all customers without discrimination and without override of that unless the consumer has abused this privilege in some way and the program in some way. That has to be considered a finance charge. Otherwise, the APR is zero. So what is there to disclose?

Then the disclosure at the time of the opening of the account could be, as I mentioned, the chart. So for example, the consumer would know the relationship for overdrawing by $50 or withdrawing cash from an ATM of $50. If the fee is $25 for an NSF fee, which is a typical NSF fee, and they pay it back in, say, seven days, you can tell them that the APR is 2,607.

You could pay it back in two weeks, which is really when your next payday is and so for many people that is when they would pay it back, 1,104 percent APR or, if you pay it back in the full 30 days, because most of these programs allow you to go up to 30 days, then that same amount of money with that same fee is 608 percent. You can give them a chart with varying amounts of money.

So it wouldn't have to be tailored to that particular transaction at that time. It's a warning to say, you know, if you are going to be overdrafting, it's not just writing checks; it's using the ATMs. It's getting cash in a variety of ways, which makes it very easy to access. People should know the cost of -- the real, true cost, the transparent cost to them of what's happening. That would help them decide not to use it or abuse it, even though it is being marketed to them in a way to go from payday to payday.

On the payday lending side, the Board and the staff a few years ago made it official and added to the commentary that payday loans are credit, extensions of credit, and disclosures need to be given on that side.

This product is no different, in my opinion, than that particular type of loan. It operates the same way, has similar high fees. It certainly is credit and should be treated as such. Again, the disclosures could be tinkered with so that it's an open-ended transaction.

I guess the last thing is -- Should I stop?

MR. MARQUIS: You don't have to stop. You'll get another chance, if you like. But I have a question for you. So you are suggesting that the transaction be treated differently based on how the decision was made to give the consumer -- to cover the check.

As far as the consumer is concerned, the fees are the same. The result is the same. The NSF check is covered. But if the decision was made *ad hoc*, it's not covered by whatever disclosures you would like, but if it is made systematically, it is covered. How does that make sense?

MS. RENUART: Because I think it preserves the bank's discretionary ability to pay checks or to honor an ATM withdrawal rather than saying, no, you're not going to get any cash, in those instances that it chooses to do that for particular customers on a discretionary basis.

That has been a service that the Board has recognized up until now as not covered by the Truth in Lending law. In order to retain the integrity of that, but to address this new product, which is quite different because it is a systematic payment, the rule should be different.

MR. MARQUIS: Ken?

MR. BORDELON: Thank you. Excuse my voice. I seem to be allergic to Washington.

Credit unions have traditionally provided overdraft privileges through savings and loans, and have continued to do so. We are also faced with this marketing campaign of providing this service and actively market it to our members.

I've got some really, I guess, personal issues that I see with this program, but I think when you look at a couple of things -- One is I guess the Fed is doing too good a job. There is no such thing as float anymore. So NSFs are more of a problem, and we are finally educating our members that there is no float, and now we are going to start marketing to them that, well, yeah, there is kind of. That does bother me.

When we look at regulation, I do remember that one of my favorite federal regulators told me that regulation basically is -- It is drawing lines and basically is a box, and to try to keep an institution in that box, and no pun intended with the Fed box in Truth in Lending. Then you have further regulations and policies and procedures within the institution, and you further limit and restrict that product or service. In a way, you stifle innovation.

I think this product has been developed, as Elizabeth said, maybe flying below the radar of Reg Z, and providing a service that, obviously, our credit union members and bank customers seem to enjoy or at least take advantage of not having to pay, in some effect, due NSF fees, one to a financial institution and one to the merchant.

The question then becomes whether it is a loan or whether it is covered, as Earl says, in the Truth in Savings under the fees. If it is a loan and it is covered under Truth in Lending, you basically kill the program being available to being offered by credit unions because of the 18 percent cap in Truth in Lending.

So we would definitely take issue with that, as far as for whether it would be available to credit union financial institutions. It doesn't mean that I really like the program the way it is being marketed.

Again, I think it is -- We are trying to educate our members to financial responsibility, and when you see some of the ads here that I see that NSFs are being advertised as newly secured funds, it just bothers me that, if I have to operate a financial institution and to drive my bottom line by increasing NSF fees, then I think my priorities are not in order.

So I think the attention that's been drawn to this has been by the marketing issue. I agree with Anthony that, if there is some coverage through truth in advertising or some other respects, that the Board should take a look at the whole program.

Reg Z is in the advanced rulemaking stages. This is a good opportunity. I agree with Agnes, a slow review of the product. We do know Reg Z has other holes in it, my favorite one being the zero percent car loans. That seems to fall on deaf ears, but while we are looking at Reg Z, this is probably a good product to take a look at, at the same time. Thank you.

MR. MARQUIS: Anthony, Ken agreed with you, but go ahead.

MR. ABBATE: I don't disagree with Ken. I do disagree with trying to wrap overdraft privileges in the shroud of Truth in Lending, because the purpose of Truth in Lending is to promote the informed use of consumer credit by providing disclosure for comparison shopping for credit.

When overdrafts occur, the consumer is not in a position to comparison shop. Providing notices in advance is not practical, because notification would be after the fact. Until the check is processed, the amount of negative balance is unknown, and there is insufficient time to provide the customer with notice before the check is accepted or rejected.

This would prevent the ability to comparison shop, which is the underlying purpose of Regulation Z and the Truth in Lending Act.

Now as to the point that Ron brought up about a line of credit being available through the ATM to promote overdrafts, and in fact, that is not overdraft banking. That is a loan and should be subject to whatever regulation applies in that instance.

I will also say that the reason that my company uses decision software is that it has the technical ability within our software to do this, but more importantly, with the vast turnover that you have today in our industry, it is very difficult to keep the same people in the same positions who would know the customer day in, day out, year in, year out.

When you use an *ad hoc* basis, it creates a disparate treatment, because there are customers that you know, and there's customers you don't know. So the party that is sitting there in that office sees a name on a list and says, I don't know that person, so I'm going to return his check, while he knows another person, and they deal with him all the time, and they pick up the phone and call.

What a decision process does is it takes away the disparate treatment and says that everyone is treated equally. Disclosure is properly made at the time the account is opened. In our case, three months after the account is opened, the customer receives a letter and said, if you want to avail yourself of this particular service, you can; if you don't, you can opt out. And as I said, I have yet to hear a complaint of anybody treated unfairly.

What everybody seems to lose sight of is, if we take away the overdraft privileges or we put in so many rules and regulations, the person that suffers in the end is the consumer. Let me give you a very simple approach.

If you pay the check, it is one charge, let's say, $25. Now if you don't pay the check and return it, it's $25. It's $25 at the merchant. The merchant generally has an agreement with his bank that the first time the check comes back, they are going to redeposit it.

So they put it through again, and it's overdrawn again, and it goes back again. So if it's a $10 check, that person is going to incur $100 in fees. So which is the better solution, accommodating the customer, let him save his dignity and be able to cover a mistake that they might have made -- and, as I said before, when I have close to 500-some-odd-thousand inquiries for balances because people don't keep a running balance in their checkbook, what are we going to do? The whole system is going to crash, and it's only because one or two separate or three separate parties have come up with marketing programs to entice financial institutions that don't have sophisticated software to avail themselves of this system, and then to make matters worse, to market it.

I do agree that it is -- In my opinion, it looks like payday lending. If you are going to do that kind of advertising, you are enticing people to take advantage and borrow money at a very high rate of return.

I really think that's where the system is broken. That has to be fixed. But as far as accommodating the whole mass of consumers out there, if you take that way from them, you are going to have a whole bunch of angry people around, because that's how you -- Frankly, I wouldn't want to pay a check and take a chance anymore. I would rather return it.

Ken is right about the usury laws. I mean, you talk about 3,000 percent. You put me out of business. I'd break the state usury law. So there's my answer.

MR. MARQUIS: I think you meant it, too.

MR. FITZGIBBON: I just -- I wanted to reemphasize, I think, something that Agnes said earlier and that perhaps hasn't been emphasized enough, although Anthony mentioned it here.

That is that an informal survey of a group of our customers at the bank in Chicago is that 36 percent do not regularly balance their account, regularly meaning do you balance it once a month. We have, I think, a job to do in terms of encouraging both our customers and through the educational process that it is important for you to balance your account routinely.

It's almost, you know, frightening to think about that, that more than a third of my customers don't balance their account.

The second thing is -- and again, following up with what Anthony said -- is that this is an account process, a service which does, if managed correctly, save the consumer money. Return check charges can be more expensive than overdraft charges, $30, $35, $40.

Third, and again echoing what Anthony said, is that the process, again if managed right and standardized, does provide equitable treatment. I think that is really an important feature that needs to be emphasized as well.

Last but not least, I think we tend to emphasize this as the only product that protects customers, and it's part of a suite of services that financial institutions provide, including automatic overdraft or automatic drawing into a line of credit or into a savings account or some other type of service.

I think it has to be thought about as part of a suite of services that financial institutions can offer to their customers as a way for them to manage their budget and keep it within their budget.

MR. MARQUIS: Thank you, Tom. Clint?

MR. WALKER: Thank you. I'd like to follow up on a point that Earl had and Elizabeth brought up that I'm sure we'll get into a little more detail in the credit card context, but what happens if you treat this product under opening credit laws, and you put together a historical APR.

I'd like to submit that I think that is misleading to the consumer. It creates confusion and really does not help anybody. Both Ken and Anthony talked about the consequences of what happens if you have to disclose a 3,000 percent APR to their institutions, but I also don't think it helps the consumer.

I think the important thing to give to the consumer is something simple that they understand, and what they understand is the fee. If I do it, it's $35 or whatever the fee is. You do a historical APR calculation that, you know, even though it is required by law, how you do it does not provide meaningful information to them. They see 6,000 APR. They go… what is happening here. They get confused. They make phone calls. They really haven't gotten any information.

I think the important thing to do is make sure that the fee disclosure is given up front so that they know what it is they are paying. You know, that they understand. If it is not done correctly -- and, Ron, in response to your concern about misleading advertising. That's a problem, and I totally agree with that. But I do submit that, as far as banks are concerned, you know, the regulators' ability to take action against them under unfair and discriminatory trade practices -- if it's not banks, it's these vendors.

You know, the FTC can take action against them. I think that is one of the really avenues that should be pushed when people are doing something that is misleading. But I really would submit that treating this as opening credit and creating a historical APR calculation would do more damage than good.

MR. MARQUIS: Thank you. Earl?

MR. JAROLIMEK: It's interesting. Those are some of the very same comments I was going to make, but I will just add on the enforcement side. You know, I think one of the questions with disclosure, you know, is it clear to the customer? What is the burden on the provider? I mean, is the value to the consumer -- does that outweigh the cost burden that this would impose?

Then finally, you know, is there enough enforcement with current disclosures? I think we have the Truth in Savings Disclosure. If this letter had a model language, that could be followed. It seems to me, the regulators would have adequate authority in enforcement to look for unfair and deceptive practices, because I think some of the marketing efforts have been -- That might have started this debate in the first place, and that very well could be one of the issues. But it seems to me, the enforcement is already adequate.

MR. MARQUIS: Thank you. Governor Bernanke.

GOVERNOR BERNANKE: I had a question. It seems clear that, if a customer unintentionally overdraws, that he or she is better off having the check covered than having it not covered and paying the extra charges and so on.

I guess the nub of the issue, though, is whether or not these programs induce different behavior, whether or not they induce people to intentionally change behavior and treat them as payday loan type credit.

My question is: Is there any evidence of people changing behavior and using these programs in, I guess, what we would call an inappropriate way as a payday type loan? Is there empirical evidence? Is there evidence from individual programs? Is there evidence from marketing programs?

I guess it would be an important issue in trying to judge the relevance of these concerns.

MR. MARQUIS: Agnes, you want to answer that?

MS. SCANLAN: The Chicago Fed newsletter for January and February talks a little bit about that, saying that, if indeed education -- further education to the consumer occurs, the consumer will understand what it means to participate in the overdraft. And it has talked about the behavior, not necessarily changing, but certainly people know that this is available, and it is more of a first resort than a last resort.

MR. MARQUIS: Ron?

CHAIRMAN REITER: Exactly so. I think the problem really is in the nature of the marketing, that the marketing encourages the use of this as an extra supply of cash, not just something that's there if you inadvertently bounce a check, if you don't balance your -- do a running balance, as Anthony was pointing out, and you wind up short, but in fact it is being looked at as an alternative to payday lending, that it's just a sort of ready source of cash there to tap into.

It's in that sense that there may be a distinction here. One of the things that, I think, Anthony has really well highlighted is that there is perhaps a distinction between the more traditional banking world of paying checks.

We know, for a long period of time and well ensconced in the commercial code, banks have to pay their checks. They have to make a decision by the midnight deadline, are they going to pay or return the check. You can pay a check if there is no balance and create an overdraft. That's well established.

Whether or not it may technically be a loan, it is certainly a practice that's been engaged in for many years. But there's a distinction, it seems to me, between paying those checks that might come in every once in a while that create an overdraft and a situation where you are encouraging people to go to an ATM machine and draw money out and to create a loan or to write a check -- or perhaps come into the branch office and to actually write a check when they don't have a balance, and get cash.

It's very hard to distinguish that situation from the payday lending situation. Let's not forget that the payday lenders originally -- and many of them still are -- are check cashers. The argument was, when the payday loans were created, that this was not a loan, but this in fact was a service, and that was the service of deferring the deposit of the check so you could get paid now for the check, but the service would be the later deposit of the personal check given by the consumer.

The Board has recognized that that really is not a service, but is in the nature of a loan. So perhaps we need to look at this, at really what is going on here and to recognize the distinction that Anthony has defined between paying the overdraft and then encouraging people to use this as an alternative to payday lending, and perhaps even a more expensive alternative.

MR. MARQUIS: Dan?

MR. DIXON: Thanks. I just have a couple of questions. My company doesn't offer this service. Sometimes we are just late to the party, and maybe we will at some point. We try and keep a pretty clear distinction between which customer relationships are loans and which are deposits, and I'm having a hard time understanding how these customer accommodations are anything but loans, and particularly when it is an automated process in which there is an established credit limit or an overdraft limit.

It sounds an awful lot like a credit line, particularly when it is managed in an automated way. So I welcome any clarification that that's anything other than an extension of credit.

I'm also a little intrigued by the comparisons that are sometimes offered that this is better than actually bouncing the check. That may be true, although I'm not sure that's the only comparison that we would want to examine.

We do have a lot of checking accounts, and we do -- we encourage our customers to not write checks when they don't have sufficient funds, but in the rare case when they might, we have some overdraft protection services. You can connect to your savings account, and we will arrange to move money if you need it, or if you have a credit card and you want to set up an automatic cash advance.

Those aren't free. There are fees associated with those, but there's a disclosure regime associated with that. So I'm a little surprised that the only comparison that we hear about in the debate is, you know, the difference between slipping on a banana peel and having a train wreck. Maybe avoiding the banana peel is another comparison that would be of interest.

Finally, I think I've heard a couple of references to whether there is an issue with the marketing companies that have invented these products. I assume they are not talking to your customers. They certainly wouldn't be talking directly to mine.

So whatever marketing takes place to the consumer, I assume, is by the financial institution. So I'm not clear on how it would be appropriate to deflect any compliance issues to these third-party vendors.

MR. MARQUIS: Buzz?

MR. ROBERTS; One of the distinctions that seems to grow apparent here is between a useful service for a rare occasion and a really very costly and bad practice if used too much. I agree that consumer education is important, but I think that an absolutely fundamental part of that is telling the consumer how much this is costing him.

I'm not sure what the right way to do that is, but it seems to me that there needs to be a regular reporting on bank statements: Mr. Jones, you know, this month you've paid X dollars for these kinds of fees, and over the last period, over the last year, you've paid Y dollars for those fees.

If people don't realize it or if it's buried deep in the statement and they are among Tommy's -- what is it? -- 36 percent who really don't even --

MR. FITZGIBBON: Don't even look.

MR. ROBERTS: -- don't even look, then that's not going to provide the feedback to consumers that will educate them. But if I notice, holy moley, I've spent $100 over the last three months for this stuff, I'd better change my behavior. And if I'm not seeing that now, I'm not going to change that behavior.

MR. MARQUIS: Thank you. Mark?

MR. PINSKY: Thanks. I agree with Buzz, and I agree with what Pat said earlier. I had sort of a similar idea in what Buzz is saying, that if somehow you told people after the fact at least what it cost them, it's a teaching moment. You have a chance to explain to them.

I think there are questions also -- I wonder about the history of the pricing of this product and sort of where we came up with what the fee is, because I think, if you wanted more people to balance their statements, start charging a lot more money and, you know, tell them what it cost them, and maybe they will start balancing -- you know, maybe it will go down to 32 percent, Tommy. I don't know.

The thing I'm really wrestling with is I'm not a banker, but I am a lender, and I can't figure out how, if I'm going to let someone use my money to pay their bills with an expectation that they are going to repay me, however I structure the fee on it -- and I'm charging them a fee -- I can't figure out how that's not a loan. I mean, it's my money they are using to pay their bills, and they are expected to pay me back.

Maybe I'm being too simplistic about it, but I just -- It doesn't connect for me. I can't figure out what else you could call it.

MR. MARQUIS: Susan?

GOVERNOR BIES: Well, first of all, I'll start off my comments by saying I don't know if this is myth or law, but I always thought it was illegal to write checks against money you don't have in your account.

From hearing all of the comments, I hear a lot of agreement, you know, in the room here. At some point, this overdraft does become a loan if it is left outstanding for a period of time. A lot of us weren't comfortable with some of the marketing materials that we saw, and I agree that they appear to intentionally fly below the radar screen of Reg Z.

Regulations, you know, can be changed. There is agreement that in some way customers benefit, because they are not paying double overdraft fees. What else? The issue of contention seems to be around information provided to the customer and what form that information should take.

I don't know. Maybe I'm being simplistic. That seems to me to be a fairly easy issue to resolve, if we put our heads together and talk about it. I understand the concern about the usury if we quote rates in terms of APRs. That is a real concern.

I also understand -- I agree that we shouldn't be leading customers to believe that they actually have more in their accounts than they actually do. We should be disclosing that fairly as well, so that the customer is aware of what their balance is.

So I guess, in conclusion, I think we can resolve this, some points, and I agree with Agnes with consumer education, and the matter deserves further review.

MR. MARQUIS: Thank you. Larry?

MR. HAWKINS: I don't that, you know, based on how long a consumer or company is overdrawn then determines whether it becomes a loan. You know, when the baby is born, it is a baby. When you overdraw, you've just loaned him money, whether it's a consumer or whether it's a company. It's a loan, Day One, bottom line. But the industry has never historically looked at overdrafts as loans.

I don't believe that, really, it needs to change and do anything different. What I continue to hear is that there are concerns about how the product is marketed. So I think there needs to be some focus on changing that.

Then my other concern is, if you do have even if your -- It's a systematic approach that you take. I guess what I've got more concern about is that, if you've got zero in your account and you go to an ATM machine and it tells you you've got $500 available or $300 available, I think, clearly, you have established some kind of line of credit.

So my thing would be to focus on that. You go to a machine, and essentially if you've got zero and it says you've got zero, and then once again it's up to the bank's discretion to really pay or return, it's a different situation. But if the system tells you you've got something available, you do have a loan, and then I think that essentially it's difficult to escape Reg Z when you've got those kinds of arrangements and those kinds of situations.

MR. MARQUIS: Thank you. Connie?

CHAIRMAN REITER: Oscar, you have another couple of minutes left.

MR. MARQUIS: Okay.

MS. CHAMBERLIN: I guess, listening to this discussion, I am reminded of what I think was an analogous experience with a gas company. I had neglected a bill for something like $4.00, and lo and behold, on my next month's bill I got slapped with a substantial late fee. On that bill was a statement of the APR that resulted from my having to pay a $20 late fee on a $4.00 bill.

You know, the APR was what, 400-some percent. That was a real educational experience, and it seems to me to be highly relevant to the type of consumer information that we are talking about today.

So I think, in addition to the marketing issue, which is obviously a particularly important one, there are already other elements in the financial system that are doing this and that are providing the APR for fees that are charged for money that was essentially loaned because I took your product and I haven't paid you for it yet.

MR. MARQUIS: Thank you. How about another comment from Anthony, and then I'll wrap up.

MR. ABBATE: I'd like to say that I hope that you never have to deal with a customer whose check has been returned. It's not fun. Okay?

Now to answer Mr. Dixon here about the amounts of $300, $400, $500. All those amounts came about because that's the individual bank's appetite for the risk. Let me tell you a little bit about how this works.

People -- We offer overdraft lines of credit, traditional credit repayable over 36 months. People don't want to be bothered filling out an application, bank getting a credit bureau and having to go through all of the formality of establishing the overdraft line of credit.

A financial institution has to set interest rates that will offset the amount of the risk. Why? Because it's unsecured credit, payable over a period of time. When you have somebody who has overdrawn his account, you've got him up front and personal, and he's not going to get away from you, because the next day you are going to see that overdraft again.

When you have an overdraft line of credit, it's out of sight, out of mind. The guy could make minimum payments or he could keep on drawing on his line and kiting on the line, and finally when you get to the 36th month and he's already drawn it up to the maximum, you go to find him. He's already declared bankruptcy.

So there's the difference between one product and the other product. But more importantly, I think yesterday we had a discussion about unfair and deceptive practices. I believe that the discussion came up whether the Fed has the right to remediate practices that are deemed unfair and deceptive without regulation.

I think in this instance that's where the direction of the Fed should go, and if the practice of advertising is unfair and deceptive, the Fed probably has enough ammunition in its weaponry to be able to deal with those people who are advertising this in a deceptive and unfair way.

MR. MARQUIS: Thank you very much. I want to thank you all for a very healthy and informative discussion. I think we agreed on a number of points.

I think we all agreed that it is important to tell the truth. Don't deceive consumers. Tell them what they are getting into. Don't spring this kind of service or fee on them.

I think we all agreed that covering NSF checks is good. It's good for some consumers. It's probably good for all consumers. They save money, if it's done.

I think we all agreed that there is an issue -- there may be an issue with advertising of these products. Consumers should not be encouraged to write NSF checks on money they don't have. They shouldn't be told at the ATM that they have more money in the account than they actually do.

I think where we had a disagreement was on the kind of disclosures that should be made to consumers. Should they be told -- They are currently being told what the fees are. They are being told that they are paying $25 for the coverage of the NSF check or whatever the fee is. Should that be converted to an APR or not? It seems to me, that's where the discussion -- where we couldn't really come together. Maybe the staff and the Fed can tackle that one.

Thank you very much.

CHAIRMAN REITER: Thank you very much, Oscar. Pat, would you take on the discussion now of predatory lending?

MS. McCOY: Of predatory lending?

CHAIRMAN REITER: I'm sorry.

MR. GARNER: Thank you, Ron.

CHAIRMAN REITER: Just looking right at you.

MR. JAROLIMEK: The Community Affairs and Housing Committee met yesterday and took up the subject of predatory lending. The Council and this committee has take up this subject on several occasions in the past couple of years, and what we tried to do this year was to try and narrow the focus a bit on more specific predatory lending issues.

For this discussion, we focused in on unintended consequences of new laws to address predatory lending. More specifically, we wanted to hear views and discuss views on the impact of credit availability and views on the appropriateness of federal preemption of state and local predatory lending laws.

We were privileged to have two very credible and well-informed speakers join us yesterday and make presentations. Dr. Michael Staten, who is a Professor and Director of the

Credit Research Center at Georgetown University, provided an analysis of North Carolina predatory lending law.

He furnished the committee and spoke to his study called "North Carolina's Sub-Prime Home Loan Market After Predatory Lending Reform."

Mr. Eric Stein was our next speaker. He is President of the Center for Community Self-Help, and his subject was reasons that states should tighten predatory lending laws. He spoke to his study, and that was titled "Regulation of Sub-Prime Mortgage Products: An Analysis of North Carolina's Predatory Lending Laws."

So as you can see, North Carolina's law became the test case, if you will, of the discussion and presentations.

With regard to impact of credit availability, Mr. Staten in his presentation and study made the argument that non-predatory sub-prime lending has been suppressed or squeezed out. He cautioned against throwing the baby out with the bath water.

He compared lending patterns of other surrounding states, including South Carolina, Tennessee, and Virginia, as evidence, in his views, that there was a greater pullback by sub-prime lenders in North Carolina than surrounding states.

Mr. Stein -- He acknowledged that the market has declined in North Carolina -- this was a point of agreement between the two gentlemen -- but argued that the North Carolina law has not hurt the availability of credit.

Evidence he suggested was that no sub-prime lenders have left the state. His belief is that the law has helped the predatory lending problem in North Carolina, loans that he has seen since the law has been in place are of better quality, and that there is enough availability in North Carolina.

It bears mentioning that there were some observations about the data that were used as the foundation for the presentations and the studies. Interestingly enough, both gentlemen defended their own data and questioned the reliability of each other.

Mr. Staten used data supplied by the American Financial Services Association, AFSA, which is made up of nine sub-prime lenders who built a database of lending data and included pricing in their data. Mr. Stein used HMDA data supplied by the federal government.

Reliability arguments ranged from content of data to its depth and origin, and even peer review for validation.

With regard to appropriateness of federal preemption of state law, Mr. Staten made the argument that a patchwork of state laws is hurting availability of credit. Some industry reps agreed that the resources at the state level to enforce state laws are scarce.

If a federal law is eminent, there were some arguments that said that perhaps before that step is made, the HMDA changes and HOEPA changes ought to play themselves out so we can see the effect.

Mr. Stein argued that a more local solution offered only by state law is more appropriate and useful.

Finally, there was some discussion on the OTS preemptive moves in New York and, I believe, some other states, and agencies' positions to enforce existing predatory lending laws.

So we are grateful to the Fed staff for inviting the speakers. They were excellent. We benefited very much from their presentations, and our ensuing discussion after they departed was very active.

So I would now invite some of the committee members to offer their views and observations and invite the Council to do so as well. So who would like to start? Pat?

MS. McCOY: Well, thank you. Just a few comments on the two studies. I think what we saw from the two studies is that we are very much in the infancy of the empirical research in this area.

The Stein study was not a regression model. It was simply summary statistics. The Staten study is a regression model, but one that, I think, raises a certain number of questions.

On the data, I think we are all fairly familiar with both the power and the limitations of using HMDA data, which was the Stein dataset. The Staten dataset actually gets to the individual sub-prime loan level, which is desirable, but it's a select group of lenders whose identities are not disclosed. So I have some concern about selection bias in the companies used.

The Staten paper was set up as a natural experiment with looking at the before and after effects of the North Carolina law. The difficulty is that the before and after pivot was the date of passage of the law, not the date on which it went into effect. And in fact, the entire period surveyed was before all of the provisions of the law save one went into effect. So we really can't tell very much about the effect of the North Carolina law from that.

The other question that we posed to both speakers is don't we also need to attempt to quantify the reduction in the dead weight loss to consumers from the elimination of abusive acts? That's not a question that Mr. Staten set out to raise, and he properly suggested that that is a topic for further research. Mr. Stein set out to raise it. We would probably like more powerful methodology to tackle that question.

So I think what we see is that it is really too early to evaluate the effect of this law based on the data that we have, and premature to either accept that law or reject that law based on this data. Thank you.

MR. JAROLIMEK: Yes, Connie?

MS. CHAMBERLIN: Well, I guess I would echo Pat's thoughts about the prematurity of any kind of federal preemption discussion. I think one of the things that is worth noting is that, really, no one in North Carolina is complaining about the North Carolina law.

The law was passed with a coalition of industry and consumer advocates, and when the study that Mr. Stein presented yesterday was released at the press conference, they had the Governor, the Attorney General, and a representative from the North Carolina Banker's Association.

So as external parties look at what is going on in North Carolina, I think that is an important point to keep in mind. It is also true that, as Pat said, both studies, indicated that there had been a drop in the number of sub-prime loans that were made in North Carolina, but North Carolina still retains a very high percentage of sub-prime loans compared with the rest of the country.

At a previous meeting of this committee, we had a presentation from the Reinvestment Fund and, as I recall, the study that they are doing, which is actually an attempt to define predatory lending within the sub-prime market, indicated that they are seeing that approximately 15 percent of sub-prime loans are actually predatory.

North Carolina, the Center for Responsible Lending's position is that the loans that are not being made in North Carolina at this point are part of that 15 percent that are no longer legal within North Carolina.

I think we also have to remember that a reduction in originations is not necessarily a bad thing. First of all, we don't know what the macro factors were that were having an influence on this, but also if, for example, you eliminate flipping, by definition you are cutting down on the number of originations, and that in itself could be a very good thing to protect consumers against predatory lending.

So I think one thing that many of us did agree on was that it is really premature to consider federal preemption.

MR. JAROLIMEK: Connie, I think you hit on a very important point. I think the crux of the discussion, probably the difference or the collision of the two studies, was the reduction in lending attributed to a decline in predatory lending or a decline in valid sub-prime lending. That's where I think the data may have collided, if you will. Ruhi, you are next.

MS. MAKER: I'm an attorney, and I practice in upstate New York in a public interest law office, and I don't have regression analysis. What I have is a lot of clients. I have doubled my number of clients in the last three months. From the number of clients I had within the last two years, I've had a doubling in the last three months.

We did pass a bill in New York. I was very involved, and it will come into effect in a couple of weeks, and I would be extremely sad, nervous, if anyone tried to undo the work we have done.

What do my clients show me? My clients are all protected classes. Almost every single one of them is a senior, a woman, a person of color. The other thing that, to me, frankly, is astonishing, and that is not something I would have been able to say even six months ago: All of my clients with high cost loans have egregious terms, and they have had 10, 20, 30, 40, $100,000 of equity either stripped or will be stripped over the life of the loan.

The vast majority of them were in prime loans where they consolidated a small amount of consumer debt at a higher interest rate to a lower interest rate, but the majority of the loan was a prime loan that was flipped into a sub-prime loan.

You know, we have done the calculations on these, and there is no way these loans were good for our clients.

The other interesting characteristic of these loans is that these are not people in default, not all of them. Many of them are current. They came to us because they were referred to us by our Community Development Credit Union where they basically said this is a sub-prime lender, let's send them to the law to review.

So these were not clients who necessarily self-identified as I got a bad loan. Most of them probably had no appreciation of how much equity has been stripped. Some of them still don't, and it's almost like I feel nervous explaining to them how bad a deal they got.

For me as a lawyer -- I mean, I've been practicing over 20 years -- to have more than half, 60, 70, 80 percent of the clients walking in where it's, well, look at this, and that there would be a potential legal claim or what happened to them was really a bad deal, that's a very, very, very high percentage. I mean, normally you say, okay, you have 10 clients walk in. Maybe one of them is going to have something that could be a legal thing.

All of these loans will not be made under the New York bill, assuming we don't have it preempted or have it taken away from us, and that will be a very good thing.

You know, the same players that we all hear about are right there. You know, we see some advances with some of the acquisitions, but frankly, we are all holding our breath, and what's going to happen with the moving forward for all my clients -- you know, okay, you're going to reform A, lending institution B, lending institution C, but my clients all owe more than the house is worth.

I cannot refinance them, and I cannot get them out of -- take away the fact that their equity has been stripped. They won't necessarily show up as defaults. They won't necessarily show up as foreclosures. But those low- to moderate-income families will lose essentially thousands -- You know, I think I estimated a couple of million dollars in my tiny, tiny sample. To me, that is very scary.

I would say, let us flourish. Let the states flourish. Let's see what happens. You know, all of us will cut the HMDA data. We will cut the sub-prime data, whatever data we can get. We do a lot of data analysis.

We think we've fixed the problem in New York that was broken, and I would be very, very nervous of the Board urging a bill that was a ceiling. You know, if we get a federal bill, let it not be a ceiling. It can be the floor, which is the case for a lot of consumer protections, and that's where I see us moving forward.

MR. JAROLIMEK: Elsie, Tommy, and then Martin.

MS. MEEKS: I just wanted to follow up on a point that was made yesterday that I thought was a very good point, that once you start looking at federal legislation, it's very hard to amend that. At the state level, while there may be some flaws in the state laws -- in Georgia, there was, evidently, and that has already been fixed. I mean, they said that, you know, as this coalesces, I think, the model will improve itself and can be fixed a lot faster than it can be at the federal level.

MR. FITZGIBBON: I think there were some segments of the discussion yesterday relative to Federal preemption and some other things that I think were important. One was that, by establishing some standards in certain segments of this issue, we might be able to come up with some solutions that would give at least some long-term benefits to the consumer. However, there were even in the data of the studies that we looked at yesterday, and I posed the question to the people from Georgetown, is the whole issue of the delivery channel itself.

This is the major form of credit in this country, that 72 percent of the transactions come from a fragmented, tattered, replaced only -- probably replaced the door-to-door vacuum cleaner salesman, has very little licensing or supervision. Has licensing but no supervision, no disciplinary actions, no controls, frankly, over the delivery channel.

It is left to the devices of the investment community to do the due diligence on the delivery system. Too often, we've seen where the investment community -- this is not necessarily the banks or the regulated depositories, but where the crooks have been connected up with the capital markets by virtue of this unfettered and uncontrolled cadre group of originators that are out there.

The studies don't deal with that. I think the studies need to deal with that. One of the things we need to look at in the North Carolina law is how many brokers do we have who have criminal records before, and how many of them have criminal records after; because the discussion yesterday was about one of the most egregious groups called Chase Mortgage, no relationship to Chase, but it was run by a group of folks who got together while they were in prison on drug charges who were in the mortgage banking industry, and yet there were no controls over that.

I'm sure -- I'm certain that that goes on today. It wouldn't happen in the banking industry with, you know, the people who would be disciplined out of the business. We need to get those criminals and crooks out of the business. I think that is one thing that perhaps some form of federal oversight would help us control.

Last is really looking at whether or not we should or could in this federal preemption establish some standards for due diligence at least by the regulated depositories in terms of what would be required in terms of oversight of the delivery system, the channels where these customers are developed.

MR. JAROLIMEK: Mark and Hubert and then Elizabeth.

MR. PINSKY: I don't want to too much repeat what I think Elsie was saying, but I think one of the really interesting, sort of the currents running through the question was around this issue of unintended consequences, was how policy is going to get made.

If you go back about four or five years around this issue of predatory lending, there was a general sense that having any kind of a law, any kind of policy, was going to be bad. It was going to squelch business. It was -- you know, all sub-prime lending would disappear.

I think we've actually come remarkably far, but we really have just started. I think that one of the -- My sense is that one of the unintended consequences of the state laws and the way that it is playing out could be a premature federal preemption.

I mean, my own sense is that inevitably we will have some kind of a federal preemption when there is some sort of consensus that happens at the state level, but we simply don't know enough at this point, as Pat was saying earlier.

I think that -- You know, I thought that the more we -- or at least the more I understood Dr. Staten's study was, it wasn't a before and after. It was a before and a before. It's very hard, and the dip you saw in the sample was among those folks who were most opposed to the idea of imposing the statute at all.

So we really don't know at all, in my opinion, what the long-term consequence of that is. We don't know whether Eric Stein was right and whether his perspective on North Carolina is right. We only have anecdotal evidence about that.

As Elsie said, you know, there have been other states that have tried other approaches. In Georgia, the issue was about how do you assign liability to investors, and there was a sense that perhaps that law overstepped, to some extent. But there was a remedy to that, and it was a fairly quick remedy, because I think that people on both sides realized the consequence of that really was that sub-prime lending -- it was going to overreach and that you were going to -- Maybe it wasn't the 15 percent the Reinvestment fund said was going to get knocked out that was just predatory. You were going to knock out 50 or 60 or 80 or 100 percent of the sub-prime lending, which is not an outcome that anybody was after.

So I think, you know, Eric Stein yesterday talked a little bit about, you know, the states as laboratory democracies -- laboratories of democracy, and I think that's a preferred choice at this point. I think we need to let the states continue to try and figure this out.

I think there seems to be a sort of a convergence on what the proper way to go about doing this or what the acceptable way to doing this, the workable way of doing this, the effective way of going and creating some state statute was.

You know, my hope is that that has a chance to play out while we gather, hopefully, more empirical data, and I think that the Fed can be very helpful in doing that, that allows us to figure out what really is going on from this.

MR. JAROLIMEK: Hubert.

MR. VAN TOL: I agree with Tommy's point, that bringing brokers into the regulatory format somehow is an essential part of it. I also want to talk about some of what Mark just brought up.

I think one of the key issues that people are struggling with now is the assignment of liability issue. In Georgia, we just had this hissy fit of industry, and a lot of it I really see as political opportunism, because the change in the governorship and the legislature there made it possible for industry to do a tremendous rollback when only a minor rollback was really needed.

I think, from a consumer's perspective, there has to be some assignment of liability, because with 70 percent of these loans coming from brokers, with the rapid turnover, if you don't have some way of assigning liability beyond the originator, there will in effect be no protection at all. From the secondary market's point of view, that liability can't be too draconian, because that limits their ability to deal with it.

I think, if Georgia had just held firm, about 75 percent of those lenders who immediately declared that they were leaving the state would have come running back with their tails with between their legs in about five or six months, and for the rest of them it would probably have been good riddance. But I think that is one of the crucial issues that has to be sorted out before we can talk about exactly where to create any preemption, if we in fact should do that at all.

MR. JAROLIMEK: Elizabeth.

MS. RENUART: I agree that the discussion has shown that really there's only two studies out there. However, there is one other instrument that was made public, and now I can't find it on the web site. It's an entity called Morgan Stanley. But Morgan Stanley had done a survey of 300 branch managers, and it reported its findings in what's called diversified financials on July 31, 2002.

It interviewed 300 branch managers of the following companies: Household, Washington Mutual Financial, Wells Fargo Financial, City Financing and Countrywide, as well as independent mortgage brokers. So we are talking about a significantly large part of the market share represented by this.

Essentially, what those branch managers reported was very interesting. They said, and I will just quote and read: "Conclusion No. 2" -- and for those of you who can't get your hands on the report, and I would be happy to provide copies -- "Predatory lending regulations have not significantly hampered growth. To our surprise, we found no evidence to support the view that regulatory pressures, the threat of legal action or changes to lending practices have hampered the growth process. Though most branch managers told us that companies have adjusted some of their lending practices, they do not expect and, in fact, are not seeing the slowdown in growth. To the contrary, many believe that new lending practices will reduce volume."

In addition, on page 2 they say: "Even the toughest new laws" -- and they did survey branch managers in Georgia, and this was just prior to the effective date of that law, but "Even the toughest new laws in states like North Carolina, for example, don't seem to be affecting branch volume."

So that, I think, should be added into the mix in terms of how the survey shows what industry's perspective is.

I wanted to comment about the Georgia law briefly. That is, in addition to strict liability position, Georgia law created a second-tier cutoff that, for example, COPA doesn't have and other state laws do not have. That is that it's that intermediate tier, and additional regulation was placed on that intermediate tier.

So that the loans where the points and fees were below -- I'm sorry, were above 3 percent but covered a lot more loans in that regulatory regime. They didn't just have no regulation versus high-cost regulation. Lenders that I just described that were surveyed are not the ones who found to be withdrawing from Georgia, at least prior to what --

MR. JAROLIMEK: Buzz, Stan and Diane.

MR. ROBERTS: One of the -- A couple of the interesting points made yesterday really relates to the idea that we are still figuring out how to do this, and I agree with Hubert that we probably need to figure out ways to extend liability in some reasonable way up the food chain.

One of the things that appears that we have learned right is the idea that you want to move the form of costs that a consumer pays away from fees and toward interest rates, build those costs into interest rates.

There is a recognition that higher-risk loans should be priced differently and higher than lower-risk loans in order to get the credit extended, but that if those costs are built into a fee structure rather than through a rate structure, then once that loan is made, a homeowner's equity has been stripped, and there is nothing they can do about it. But if they simply make the mistake of borrowing at too high an interest rate, they can always refinance out of that.

That's a fixable problem, and it is also a problem that the marketplace, through greater competition, can begin to address. So I think we should take some solace that we are beginning to learn some things.

MR. JAROLIMEK: Dan?

MR. DIXON: I have mixed feelings on the question of the state activity and the preemption at the federal level. I think what concerns my company, which operates in -- lends in something like 35 or so states -- is not so much that these are different rules on a state-by-state basis, but more that they are constantly changing, and it's just a matter of the challenge of keeping up.

As a practical matter, I think that we tend to be almost exclusively a prime lender, and almost none of these end up impeding on any of our loan activities, but you can't ever be sure, and you have to pay attention and so on.

I assume what is really going on is not that those who are trying to provide additional consumer protections are not really in love with 50 different flavors as much as it's the process of getting from inadequate protections to more adequate protections and the option process that is occurring as we go from state to state to state.

My personal preference is, let's just all get in the room and work out the set of rules which provide those protections and, you know, save ourselves all this agony of getting from here to there. But as a practical matter, I'm just demonstrating how hopelessly naive I am. So continue to try and be helpful along the way.

I might also make one comment about the issue of the preemption by the federal banking -- Office of Thrift Supervision, OTS, which in fact issued letters acknowledging that it has the preemption in the case of Georgia, New York and OCC, the Controller's office is, I guess, in the process of considering a similar action, at least in Georgia.

Again, I mean it's like an economist. There's on the one hand, on the other hand. It may actually be less than it seems. As a practical matter, the preemption doesn't relieve the obligation of the mortgage brokers who are originating loans for delivery to federally chartered financial institutions. Those loans are still subject to all the state statutory requirements.

Indeed, to the extent that there is assigning liability in the statute, if any of the loans that my company originates are ultimately sold into the secondary market, then the investors are still subject to those whatever limits that a state ends up with for assigning liability.

So it's actually a fairly narrow preemption, but it is, I think, also important to recognize what comes with that preemption. The Office of Thrift Supervision spends a very large amount of time on a preventive medicine basis, if you will, examining my company's operations to ensure that we comply with all of the various and sundry consumer protection statutes, not just because some consumer has complained, but on a proactive basis, if you will.

That level of examination and oversight, I think, provides a hugely important consumer benefit, and as we think about it, in fact, the fact that the federal regulators are providing that oversight and enforcement maybe, in a sense, frees up the resources which are already too scarce at the state level that have new obligations under the state rules. Then those scarce resources can focus on the companies which are not otherwise being examined by the federal regulators.

So I think that, one, it's not much and, two, it maybe provides a lot of benefits that haven't necessarily been acknowledged.

MR. JAROLIMEK: I just want to tail on Dan's comments real quick before I go on to Diane and then Robert. But it's an interesting point you raise, because the points of agreement in the committee yesterday were that predatory lending is an extremely bad thing, and we all agreed. I mean, it doesn't matter where you're from. It's a bad thing.

The other thing was that it probably doesn't involve prime and good sub-prime lenders. You know, it seems to me the big concern of the industry, if you will, is that the laws being passed still need to be adhered to, and the unfair label is an extreme concern.

Maybe the rules in and of themselves with the unfair label threat, if you want to call it that, have already made a difference. So Diane, and then Robert.

MS. THOMPSON: I want to talk just a little bit about this question about credit availability. I work in East St. Louis, a city that was almost entirely gutted by redlining during the 1960s and '70s. We care very much there about credit availability. But what we care about is the availability of good, responsible lending.

Our office has always done a great deal of home defense, but until the mid-1990s virtually all of our work in home defense either involved installment land contracts or it involved workouts with mortgage companies. I used to see lots of FHA loans. I used to see lots of 6, 7, 8 percent interest loans.

Starting about 1997, every single person that walked through the door had a loan with terms in it that violated federal law and state law. I have not seen a single set of loan documents on a client that walked through my door since 1997 where the terms were entirely in compliance with all applicable laws.

That's in addition to the vast majority of these cases involve egregious fraud, fraud that I believe is clearly -- that happened at every single level of the transaction, from the broker, the home improvement contractor, up through representatives of the lender.

I think it's important that, when we look at the Staten study, we realize that he in fact did not address this question of what kinds of loans were not getting made in North Carolina and has admitted as much.

The only aspect of his analysis that goes to this question, are these good loans or are these bad loans, is the interest rate spread. But as Ruhi has said, and as I think all of us know, most of the predatory practices that we see are not in the interest rate premium.

As Buzz pointed out, many of us in this area would like to see the banks get their risk premium in the interest rate, because that is something that is easily understandable for consumers to shop for. It makes sense. But most of my loans -- I'm looking at loans where the interest rate is between 12 and 18 percent, and we're looking at fees of 5 to 10 and sometimes even higher percent.

I want to know whether or not North Carolina squeezed out some of those loans with the high fees. I want to know whether or not it squeezed the loans with the balloon payments. I want to know whether or not it squeezed out the flipping loans.

I want to know whether or not it squeezed out the loans to the 68-year-old woman on SSI who thought she was renting the house and didn't understand that she had bought the house and had a mortgage on it until she received foreclosure papers, because the person who was collecting her rent hadn't forwarded the money on.

I want to know about those loans, and we don't yet have any information as to whether or not those are the loans that have been squeezed out, the loans that, as we all agree, are bad loans, should not have been made, do not add any benefit not only to the families but to the communities.

We need to know what kinds of loans are being squeezed out before we come to any conclusions about whether or not this kind of regulation is good for or bad for credit availability in low income and minority communities. Thank you.

MR. JAROLIMEK: Robert, and Hubert.

CHAIRMAN REITER: Ronald.

MR. JAROLIMEK: Ronald.

CHAIRMAN REITER: How quickly they forget.

MR. JAROLIMEK: I see. I'm sorry.

CHAIRMAN REITER: Thank you. I just wanted to touch on sort of the three major points that have come out in the discussion.

First of all, with respect to preemption: The issues of predatory lending often involve matters of deception, often involve terms that are oppressive in one fashion or another, and the nature of predatory lending varies from state to state. While there certainly are a lot of similarities, there are also differences, and the differences very often are predicated on the differences in the real estate market and also the differences in the population.

The real estate market is significant because of the kind of housing stock. Ruhi and I were talking just yesterday. She has homes in Rochester which are $25,000. I don't think in California you can buy a bedroom in a house for $25,000.

There is much more equity in a number of states, a real estate market which makes those states sometimes more vulnerable, or more attractive rather, to predatory lenders. The population in California is probably more diverse than anywhere in the nation. Twenty-five percent of the people in California were born outside of the United States. We have many different languages spoken. The kinds of problems are quite unique and not really amenable to a one-size-fits-all federal solution.

Certainly, there is no problem with establishing some minimum standards, as Truth in Lending, for example, does. Truth in Lending allows states to come up with more protective provisions, as long as they are not inconsistent with anything specifically provided in Truth in Lending, and that sort of approach is helpful. But an approach that establishes a ceiling that prevents states from dealing with their unique problems, I think, would be a travesty in this area.

Secondly, many of the players, the people who create the problems, tend not to be the national banks or federally chartered savings banks, but tend to be brokers and finance companies. While there is a penchant for some of the finance companies to turn themselves into federally chartered institutions, we still have enough control at the state level that it's more amenable to state treatment.

Thirdly, enforcement is far more effective at the state level. Part of the reason for that is that the sort of people who are victimized are more likely to walk into the neighborhood Legal Aid office, the neighborhood police station, to deal with the local consumer affairs organization, rather than sending a letter off to the OTS in Washington.

Also, I think enforcement is more supple, and we are able to take swifter action under state unfair trade practice laws, and certainly, if there are state predatory lending laws, that only enhances the ability of the state agencies to take action.

I would say that the overall impression of many state enforcement agencies is that federal enforcement, particularly by the federal banking regulators, has largely been absent. It's been feckless and ineffective, and while, for example, the state attorneys general were negotiating with Household and accomplishing, I think, a substantial judgment, there was virtually no action whatsoever by federal regulators, and it's a constant battle going on by the states to preserve their ability to protect their own people against preemption, which very often means no action at all once the matter is preempted.

Secondly, just a brief word on assignments. I mean, it's very critical, of course, that by the time a problem surfaces, that one is able to actually get relief for the victims, and that often means looking to see where the mortgage has been transferred. So, as Hubert pointed out, some level of assignee liability is of some significance.

I would point to the area of automobile financing. For decades, automobiles have been largely financed through installment contracts, which are then assigned to a variety of lenders, whether they be banks or some of the large financing agencies like GMAC or Ford Motor Credit, et cetera, and many of those contracts are securitized and sold on the secondary market.

All of those contracts are subject to the claims and defenses which the original purchaser could assert against the dealer. That is so by virtue not only of state law but also by virtue of the Federal Trade Commission's Holder rule, which by contract subjects assignees to claims and defenses.

It is very clear that automobiles are sold all the time. There is no crisis in automobile financing, and if there are problems with crooked automobile dealers, those can surface at some later point, and it is possible to get economic recompense for the consumer victims without destroying the entire credit market for automobiles. So I think that's a model to look to in terms of examining whether it is possible to have some limited degree of asset liability in the predatory lending area.

Lastly, I would agree with Buzz's comments with respect to the fees and interest. Many of these fees, of course, aren't in the nature of finance charges, and so ultimately are disclosed as finance charges in the Truth in Lending statement, but in fact by not being placed into the interest factor but being included ultimately in the principal amount that is borrowed by the consumer, it prevents the consumer from ever extricating himself or herself from a loan, because if you pay these enormous fees and points and charges, those tend to get financed and put into the note rate.

Ironically, what we have seen is that the existing Truth in Lending disclosure arrangement is actually perverted by some predatory lenders who, when asked by people how much are we borrowing, the answer will be by the predatory lender, well, the amount financed is such and such, and they can say that because, even though the note, the promissory note contains all these fees and charges, and they are then put into sort of the principal balance of the note, in fact, they are finance charges and are excluded from the amount financed. So the amount financed and the amount of the promissory note can be vastly different. That is something that needs to be addressed to make sure that Truth in Lending is not subverted. Thank you.

MR. JAROLIMEK: Thank you, Ron.

CHAIRMAN REITER: Earl.

MR. JAROLIMEK: Governor Bies, do you have a comment?

GOVERNOR BIES: I have a question. I want to follow up on something Ron just talked about.

One of the issues I'm hearing from some bankers deals with the enforcement side that you were just talking about, that banks who are really looking at brokers and who are concerned that they see some fraudulent or predatory activity, they file SARs, and even maybe their security departments do investigations. But they have difficulty getting either the U.S. Attorney or states' attorneys to really pursue it. So they know the brokers have just gone out and found another channel.

So my question really is: Given the brokers are not really regulated by a bank or S&L regulator, and that's where some of the problems, we seem to be saying, are occurring, how effective are we going to be if we just continue to focus on changing regulations if we don't deal with enforcement?

CHAIRMAN REITER: I think you raise a very important point. I think enforcement is absolutely critical, and it can be improved certainly at every level.

Brokers are treated differently from state to state. Some states have licensure. There are a few states that do not. Those states that have licensure may impose varying duties on brokers.

In California, for example, brokers are held to a fiduciary duty to their clients, which is, of course, the highest standard, and there is a licensure scheme and ability to put them out of business, an ability for various state actors, whether it's a local prosecutor or the state attorney General, to go after a broker as well.

Other states are probably lagging behind in terms of licensure and oversight of brokers, and that definitely needs to be improved. But that again, it seems to me, is something that can be addressed on a state basis.

The Federal Trade Commission, of course, would have jurisdiction as well, and on occasion they take some action, but they, of course, do not have the resources to penetrate into every nook and cranny of each state to really do the kind of enforcement that local people are best able to do, if they were willing to use them.

GOVERNOR BIES: Is anybody aware, is there any information that shows the percentage of SARs, for example, where there are referrals that actually are acted upon in this area? Do we have any such information?

CHAIRMAN REITER: I'm not aware of anything in general. I mean, we normally act on it.

MR. JAROLIMEK: Tommy, I'm going to insert you, because I think your comments are --

MR. FITZGIBBON: Right. I just wanted to respond to the Governor. I think there is precedent, taking it back to the 1980s with the banking and thrift crisis, the collapse of FSLIC and the taxpayers picking up a fairly significant cost to reinforce the fund.

Congress passed Financial Institutions Reform Recovery and Enforcement Act.

Out of FIRREA came the Uniform Appraisal Policy regulations and rules, which required states to establish licenses and education and supervision and disciplinary roles for appraisers performing appraisals for federally chartered institutions as part of the opt-in provision.

I think the precedent is there. I think it's something we should pursue. Similarly, as it relates to the delivery channel for brokers and mortgage bankers. The fact is that this is an unfettered, cowboy operation that's going on. It's been doing that for years, and it's 72 percent of the mortgage product in this country, and we can't ignore that.

I think it has a potential safety and soundness impact on the insurance of depository institutions and on the mortgage-backed securities which are sold to investors around the world. We can't ignore that fact, and I think it's something that we have to pursue.

MR. JAROLIMEK: Hubert, Elizabeth, and Dan.

MR. VAN TOL: Earl, I was going to respond to your comments that are frequently heard, that preemption by the regulatory agencies would not seem to be that much of a deal, because the banks and the thrifts are the good actors in this arena.

I think, you know, to a large extent, that's true, but I wouldn't want us to have complete rose colored glasses on that. You know, some of the biggest sub-prime lenders who have been criticized by community groups around the country are now subsidiaries of major banks.

We have Citi buying Associates, and I think people certainly think that City Financial has improved that somewhat, and with HSBC buying Household, we certainly hope that the same improvement will be seen. But you can't, I don't think, assume that community groups are in agreement that all of those practices have been cleaned up.

So the role of enforcement within the banking regulatory regime is very important to look at, I think. You know, Wells Fargo has a major sub-prime effort that a lot of people have criticisms of. So those are huge institutions.

They are fully under the banking regulatory agencies, and we have to keep looking at how to do a better job of dealing with that, not only in the fair lending exams but in the CRA exams and in the merger and application process as well.

MR. JAROLIMEK: I have Elizabeth, Dan, Pat and Ruhi.

MS. RENUART: Just to address a couple of things that were said and to make a couple of additional points.

When Ron was talking about broker regulation, I have recently reviewed the broker laws in all of the states and discovered that California is the high water mark. Many states don't have any regulation of brokers whatsoever. Some states that do don't create particularly much in the way of duties of the broker or responsibilities, and it's basically an application and a registration process.

So that the supervision and the follow-up and the consequence of bad, illegal or whatever behavior is quite minimal on the state level. So it's still, unfortunately, fairly spotty except in states that have much more regulation.

Also, if we tried to regulate brokers by the federal government, HUD estimates that 60 percent -- Whether it's a traditional broker that is not also the originator or whether it's a correspondent broker, a very large number of people are entities out there. So I think at this point it's still worth leaving that at the state level to see, as part of the anti-predatory mortgage lending legislation that percolates -- and there is more focus on the broker side of it. For example, North Carolina recently passed a bill regulating mortgage brokers a bit more than before.

I think there is, again like we've been saying, time to percolate and see what creative ideas can come out of the states, particularly since probably those people are best regulated by the states. They aren't usually financial institutions or depositories.

In addition, just a reminder about Home Ownership Equity Protection Act. HOEPA is the federal statute that regulates predatory lending at the federal level. It has a very strong assignee liability provision in it, and the industry testified at the time that the sky was going to fall, they couldn't do business if HOEPA were enacted, and Congress went ahead and enacted the law.

Eventually, the effect is, frankly, that most loans aren't being made as HOEPA loans, and that's been a positive development, because that means fewer very expensive loans are being made in this country. So we can applaud both Congress and the Board for its efforts to expand HOEPA, which it did last year.

So -- and the lending industry has been able to live with this very expansive assignee liability, which Congress deemed is very important. It also is a cap on damages. So it's reasonable. It's not catastrophic liability for each individual client, and particularly not in class actions because of a class action cap that also exists in Truth in Lending.

So what the states have been trying to do is just simply expand -- I wouldn't say simply, not entirely, but generally to characterize these State anti-predatory lending laws, they are tinkering with the HOEPA triggers and making them a bit more expansive.

None of the states have really tinkered with the APR trigger. That's been left the same as you all did, which was to lower it to 8 percent for first lien mortgages last year, but they are tinkering with the points and fees trigger, and some states have it at 5 percent with a more expansive -- That's basically what they are trying to do, is because of the excessive points and fees that are being charged in many of these transactions, the states are trying to expand the HOEPA-like coverage and get at those practices.

For example, the lender that Ron mentioned about the fraud using the amount financed and how they were subverting the Truth in Lending disclosures, they were charging 10 to 26 point transactions, incredible amount, the worst I have ever seen.

So there's a reason why the states -- I realize those would have already been covered by HOEPA, but there's a reason why states -- just below the HOEPA triggers in trying to reach that market, with the exception of Georgia, which I said reached down much more significantly and incurred the wrath of that.

The problem there was that the elephant was in the glass house, and the result has been complete trampling of the protections in Georgia that were legitimate and that people may not be concerned about in order to undo what was done.

Then just lastly, that the OTS, interestingly, -- The OTS issue was -- we are not going to preempt that part of Georgia law that deals with foreclosure provisions, because that should be left to the states. So even the federal preempting agency aren't taking the whole ball of wax and saying you can't do anything in the states as far as certain depositories are concerned.

In fact, the OTS itself last year gave back to the states the authority for it to regulate -- for them to regulate prepayment penalties and late fees for nondepository institutions.

Then finally, if the bill pending in Congress now, the Ney bill, a reversal of what everyone has been used to in terms of HOEPA, because it is going to undermine HOEPA in several significant ways. It's not a responsible lending or consumer protection bill, and it does the same thing that I think the industry did in terms of trampling on the Georgia law. It tramples. It's the elephant in the glass house trampling on preemption. It affects foreclosure laws in the states. It affects mortgage broker laws in the states. It's cutting a wide swath to deal with the particular problem.

MR. JAROLIMEK: Okay. Well, regrettably our time has run out. I just want to thank all the participants for their great comments today.

Even though we tried to narrow the focus on predatory lending, we still seemed to cover quite a wide range. So I think that just gives everyone an idea just how broad a topic it really is.

So with that, thank you, and I'll turn it back to you.

CHAIRMAN REITER: Thank you very much, Earl. Well, we are at eleven o'clock, and we are going to take a break. The Council members need to gather, I'm sure, and we'll figure out exactly where we all need to go. I think we are in the other building.

(Whereupon, the foregoing matter went off the record at 11:00 a.m. and went back on the record at 11:30 a.m.)

CHAIRMAN REITER: Thank you. Let's reconvene the meeting. I'd like just to mention preliminarily to Council members not to move your microphones and, when you speak, just perhaps lean forward into the microphone but not move it. Apparently, these microphones are sensitive and are strategically placed and, if the microphones are moved, then it doesn't apparently record well. So they can't get a good transcript of the proceedings.

Thank you, and now I would like to turn the meeting over to Patricia McCoy to lead discussion on the Truth in Lending Act and some questions about credit card disclosures, et cetera.

MS. McCOY: Ron, thank you. I guess this is our test of the microphone. I take it, it's working.

In this segment of the public meeting, we have been asked to discuss issues of concern regarding credit card disclosures under the Truth in Lending Act. If I may, I'd like to kick off the discussion by highlighting two different things you might want to think about.

The first is whether or not there are overly burdensome disclosures that really aren't doing anything to inform the consumers. The second is how we might approach concerns about consumer misuse of credit cards and marketing the credit cards through the disclosure instrument.

Just if I could highlight a few facts: There are concerns today that, urged on by aggressive marketing, too many consumers have high credit card debt loads, and something that economists have often noted is that often consumers will pay high APRs on balances when they could get credit elsewhere more cheaply.

There is an interesting survey noted in the American Banker this week that reported that 47 percent of consumers surveyed only made their minimum monthly payments. That's almost half. The same survey reported that consumers typically overestimate their ability to reduce their credit card balances.

So as we think about disclosure, we might want to think about how one disclosure regime versus another conditions or can change consumer behavior, either towards destructive behavior or towards constructive behavior.

We might want to think in those terms. For example, are there types of credit marketing that encourage splurge spending? For example, teaser rate disclosures -- there is some evidence reported by Jeanne Hogarth here at the Fed that consumers are very confused about teaser rate disclosures.

Conversely, there have been reports that some consumers who do the advisable thing, which is to pay off their balances in full every month, are penalized with inactivity fees or even have their credit card canceled.

Similarly, right now we may underdisclose in terms of conspicuousness, cash advance fees or late fees. It seems that consumers underestimate their use of these features. We may want to do more to bring them to the attention of consumers.

Yesterday in our committee meeting, we discussed three specific practices or disclosures. One was the usefulness of the historical APR disclosure. I would not say that we had consensus, but there were substantial concerns that it is difficult for lenders to compute and, at least in its present format, consumers may not understand what the historical APR tells them.

So we batted around different ways that we might want to inform consumers of what that information conveys.

We had a discussion of the advisability of expanding box disclosures to the application and account opening phase plus the periodic statements. We also had a brief discussion of minimum payment disclosures and more conspicuous disclosure of late fees and cash advances.

So with that, I'd like to open this up for discussion. If I could start with our esteemed Chair, Ron Reiter.

CHAIRMAN REITER: Thank you, Pat. I think there was a sense in the committee that the so called Schumer Box, the disclosures on credit card applications, was by and large very helpful and effective in communicating critical information about charges. The information is collected together. It's displayed in a box. The type size and format is readable, and attracts attention, and is very informative.

There was, however, some concern about sometimes the qualifications that might be put on some of the terms. I mean, for example, one of the sample disclosure forms that we were given with respect to the annual percentage rate indicates that there is a zero percent rate for the first billing cycles, and after that time period then the rate moves to, in this example, 7.9 percent.

What's unclear about some of these offers is whether there is a qualification or not. It so happens, for example, in this particular offer you are only entitled to receive the zero percent rate if you made your minimum monthly payments. If you miss a minimum monthly payment, then the rate automatically goes to the 7.9 percent rate.

That fact is not disclosed in the box, but there is a little asterisk. Then if you go into sort of the mice type of the rest of the disclosure, you then find out that there is this qualification. Sometimes the qualifications are much more elaborate than that.

So there is this tension between providing all of the information in a meaningful way in one spot, and then having the brevity of the disclosures within the box and the necessity then to have qualifications outside. There is that tension, and I think it is going to depend perhaps on the nature of the disclosures and the qualifications as to whether or not the overall presentation is misleading or not misleading.

The second point that I think Pat wanted me to address was the question of whether an additional disclosure should be provided, and that is the length of time it would take to pay off a credit card balance if one were only paying the minimum monthly payment.

There is some controversy about that. There was a -- There is, actually, a California state statute that requires generic information, somewhat similar to the information on variable-rate home mortgage loans where you would have sort of a hypothetical disclosure of how long it might take.

The California statute also required an 800 number, a customer service number to call to find out transaction-specific information. That legislation is on hold at the moment, pending review by the Ninth Circuit, harpooned by preemption. But there is a question of whether this sort of information should be provided at the federal level.

The various iterations of the Bankruptcy Reform Act, which of course, so far have not come to law do require this type of disclosure, so that people have an idea how long it will take. Most people would be mystified to know that it would take anywhere from seven to 14 years, depending upon their interest rate, to satisfy an obligation only paying the minimum payment.

MR. WALKER: Great. Thanks, Pat. First of all, for those who don't know me, I work for a credit card bank. So through Pat's comment about some concern whether consumers are being urged to use their credit cards, I think that's a good thing, and I hope you all do, and hope you all use Juniper credit cards.

I have several points I'd like to make. First of all, as we discussed yesterday, one of the concerns, I think, that the credit industry has with current Reg Z is what fees constitute a finance charge and how those fees, therefore, are disclosed.

An example will be the cash advance fee. That fee is disclosed. It's in the solicitation disclosure that's here. It is disclosed in the initial statement or what most people call the card member agreement, and very importantly, when people actually take a cash advance, it is disclosed as a line item in the billing statement, which is the one area in the billing statement that consumers always read. They want to know what transactions they did, and it's disclosed right there.

I think that's great. It's appropriate. It should be highlighted. People should know what their fees are before they access various features of their account.

The thing that I think creates misleading and confusing disclosure is the fact that currently, since it is considered a finance charge, that fee is then included in a calculation of the historical APR, and all of a sudden the consumer, after they access a cash advance fee, gets a little box on the top of their billing statement that says you have an 80 percent APR, and they go, what is this all about.

They are confused. At a minimum, they are calling. You know, they are calling customer service, which is, you know, what is this all about. It's a difficult call, because it's kind of hard to explain. It's hard to explain to the lawyer how this historical APR works. Very hard for a customer service representative to explain to a consumer.

At worst, the card member says, this is terrible, this is not what I was promised, and they cut up their account. They go somewhere else, which might or might not have even a higher APR.

So that's something we really would like the Fed to look at, is what constitutes a finance charge, and whether something can be done about this historical APR calculation.

Just quickly in response to Ron's two points. We support, actually, reform legislation. I hope it goes through, and I hope it goes through with that provision you are talking about, and I think that would be great. We support it. So, the industry has supported that legislation, you know. So we'll be supportive of that.

I'm trying to remember what your other point was. I'm sure I'll get to it.

CHAIRMAN REITER: The qualifications on some of the --

MR. WALKER: Oh, yes, yes. The qualifications -- You know, again the thing with -- and I appreciate it; thank you. The important thing, I think, with regard to any sort of meaningful disclosure is that it is that, meaningful. You know, too much stuff, it gets confusing.

That's why I think the Schumer Box is an attempt to get to that point. You have an 18-point type on the purchase APR. You have certain things that are required to be there. It's an attempt to give the consumer a very easy way to compare with various other issuers meaningful disclosure.

The fact that the rate goes -- you know, the zero percent goes up if you don't pay on time is not included -- I think, one, it would confuse things if it was put in the box. Two, I think most consumers understand they are supposed to pay their bill on time. They might not -- You know, I know that's an issue, but I don't think it should be a surprise to them, and it is disclosed, as you said, in the footnote, that something bad happens when they don't pay on time.

So, you know, I would honestly say that that is appropriate. It's hard to put too much into this box. Then you really, really will start confusing customers, and you will take away from, I think, the more salient, meaningful parts that you really do want consumers -- whether you are a consumer advocate or, frankly, a bank that deals with these consumers and you want to maintain a long relationship with them -- to see and understand.

MS. McCOY: Thank you.

MR. ROBINSON: I think the main point of any disclosure is to inform and educate, and oftentimes we commingle those two terms, and we end up not educating and end up with a consumer who is not informed.

So looking at the historical APR may not be the most appropriate vehicle to educate or inform the consumer, particularly if the number is inflated to a point that the consumer goes and does things ill advised. So my comment is based on education versus disclosure.

MR. MARQUIS: According to the Hogarth survey, what consumers are concerned about when shopping for credit cards are, first, annual fees, then APR. I think they are concerned first about annual fees, because it's a dollar amount that is easy to understand, and I think APR is of interest because it is something to compare, because it's presented in a uniform way. So it's easy to compare credit cards based on APR as well as based on annual fees.

But I've never refinanced where the mortgage rate that I was told is the same as the one that appears on the box in the HUD-1 or whatever that form is. I don't understand that either.

I don't think APR makes that much sense or that it conveys real information to consumers other than for allowing comparison. So I don't think adding -- and as someone said, having an APR in the monthly statement of 80 percent -- I don't think that means a lot to consumers. They know how much they have to pay. They know the minimum payment.

Knowing how long it will take to pay off a balance at a certain rate, I don't think, really informs either. I think individuals are concerned about dollars, how much do they have to pay, and then some means of comparison shopping, which is what the APR does. But I don't think it needs to be expanded.

MS. McCOY: I wanted to pick up on a very interesting insight in the Hogarth report, which is the success story -- focused on nominal APR. That was a success story that was long in coming.

In the eighties we probably weren't there. We have now fairly high consumer focus on the nominal APR. What that suggests is that we shouldn't abandon the quest to educate consumers about the information conveyed in the historical APR.

What we may want to do, though, is label it differently. I don't think calling it a historical APR tells consumers the way you use your credit card, you have now racked up an effective annual interest rate of -- whatever.

If we can convey that information so it says you are in control of what your APR is by changing your behavior, we can start to educate consumers with the precise feedback loop that their own behavior provides.

Other comments? Yes, Elizabeth.

MS. MEEKS: Just to put this in a little bit larger context, we were talking yesterday, and I think we were charged with the mission of talking about changes to the credit card disclosures, because the staff is going to be looking at Regulation Z, because it hasn't been reviewed in quite some time.

So we were discussing these issues much more broadly than just this historical APR, as Pat originally introduced. So I wanted to go back to some of the broader discussion about the improvements, and then also specifically address the APR for a moment.

The broader one is -- and I think there was -- Correct me if I'm wrong, but I think there was a fair amount of agreement that it would be very helpful for consumers to put what is now called the Schumer Box, which you get only at the application stage -- put that also on your initial statement that you get when you open the account, so that one can compare what you were promised or what you were offered, I should say, and what you actually got in a format that is easily readable, because right now the initial statements -- there's no disclosure requirements in terms of the quality of the information, the order in which it is presented.

So it's basically a small print contract, and whatever the order of the paragraphs are, that's the order in which the creditor decided to put them in. So there is no way to, again, readily and easily see, oh, my APR -- If purchase is going to be X, my APR for cash advances is Y, and all of the other fees that have been discussed.

So that was another idea that we talked about yesterday that I at least would strongly encourage the staff and the Governors to think about.

In addition, this minimum payment issue was one that we didn't tease out, because again this was our first conversation about credit cards, specifically about changes to Regulation Z. But I think that the minimum payment issue was one that's percolating through state legislation.

Whether it will stay successfully effective or be preempted has not been decided finally, but the information can be quite powerful to consumers. I don't think it needs to be given at the solicitation or application stage, but I think it should be given either at the initial opening or subsequent billing statements as sort of a warning.

The examples that one could give would be if you had $1,000 balance, it's going to take you 17 years and three months to pay it off at a 17 percent APR with a minimum payment of 2 percent. That's pretty astounding for a consumer to hear about and that the total cost to you is $2,500, even though your initial balance was $1,000.

In addition, if it's a $2,500 balance, it might take you 30 years to pay that off. Most people do not want to take out essentially, in effect, a mortgage for a $2,500 purchase of something, or a cash advance, whatever it was.

So that's a warning. When we are talking about education, that's a very strong educational tool for a consumer, and there are ways to craft this. So it doesn't have to be loan specific to ease the disclosure requirements for the credit card issuers.

Then lastly on the APR issue, the reason why the actual APR is very critical at the billing statement stage is that the initial APR that you are told about is simply the interest rate, because there are no finance charges added into it.

That's how the statute requires that the APR be disclosed. However, once certain charges are imposed because of the consumer's activity during the length of the account, those ought to be disclosed, in my opinion, as an actual APR, because it's not just 80 percent that tells you nothing. It's the relationship between the amount of money that triggers this fee and the fee.

So that you can see, for example, that taking a cash advance out for $200 triggered a fee that gave you an effective annual percentage rate of 20 percent or 30 percent or 50 percent, whatever it was, and that's very helpful for the consumer to say, wow, I better step back, you know, and decide whether I'm going to do this again, because it is very expensive.

So it's the relationship between those two numbers that the effective APR measures. So I think the actual -- I'm sorry, the effective APR is critical at that stage, so that the consumer can see that relationship.

MR. ROBERTS: As someone who doesn't do this part of the business on a daily basis, I'm struck by the parallel between this conversation and the conversation we had earlier today on check bounce protection.

Seems to me that these are all services that, used prudently, are wonderful for consumers, and if used poorly are very expensive and detrimental to consumers, and that they have to take responsibility for responsible behavior, and they need to have the information that encourages and allows them to do that.

Seems to me that Mark's phrase, a teachable moment, pertains here, too. We need to -- People need to understand how much these services are costing them, in order for them to figure out how much they want to use them.

MR. WALKER: Thank you. Just in response, again about this historical APR, you know, as I hear, people are saying they want the disclosure in the billing statement, you know, this EAPR calculation, and what I'm submitting is that that disclosure is already made. It is made in the place where the people are more likely to read it, which is in the itemization of charges.

I mean, everybody goes through it. I'll tell you right now, if I do something like that and my wife sees it, she will yell, what is that fee that you've incurred. I mean, that's -- and I think that's consumers look at. They look at a dollar amount, look at the fee.

I totally agree, you want to disclose that so people understand what it is they are doing. The trouble with the EAPR is that I think, frankly, it is misleading. It doesn't measure the cost of money over time. It's not amortized. It is basically a one-month bump, and then it goes down again.

So I just don't think it is accurate. I don't think it is -- I think it is misleading, and I don't think we should be conveying misleading information.

MS. RENUART: But don't you think your wife would yell at you even more if she saw that it was 80 percent APR?

MR. WALKER: No, because she knows that's misleading. She knows it, you know. But it's ridiculous. But she will yell at me for that $35 fee, if I get it. I promise you. She says, what are you doing, boy. She does, I promise you.

I think that is really the point, you know, that you got to -- I totally agree with education. You got to -- People got to know what the fees are. They should know it up front when they acquire the account, and I think that is appropriate. It should be in the box. But I think doing this EAPR thing, it creates confusion. It creates extra costs for the banks, because you have extra customer service calls coming in. It creates problems for the banks' relationship with their customers, because customers say what is this all about.

That, I think, is needless extra problems with your customers, and I just don't think it serves a good consumer purpose at all.

MS. REYES: I'd like to address a point that I don't think has been brought up yet, and that is in terms of the consumer and the status of what it means to have a credit card.

You know, if you are talking about the underserved and you get something in the mail that says, hey, you've been preapproved or approved for this $1,000 or $500 credit card, wow, I feel great, because somebody believes in me and, therefore, I'm going to take it out. So the education is not there right from the get-go.

Then so it's a matter of status. Then what we also see is the fact that people get charged off from these credit cards, you know, after a certain time. So you look at their credit report, and it's a list of how many credit cards they have had and the charge-offs that come from there.

So I think that issue needs to be addressed, too. How much is too much, and where do we cut the line, you know, after how many charge-offs can you have on your credit report, or something like that, to address that into the consumer side as well.

MS. McCOY: Yes?

MR. HAWKINS: You know, sometimes I think we talk as if credit cards are something that just came on the scene yesterday. Credit cards have been around for forever. Parents have told kids who have told kids -- I'm pretty sure your parents have told you about the potential dangers of using credit cards.

Now, true, we still need to do a lot of things in terms of how we educate people about potentially what happens. Some of the new things probably that have come on the scene as of late is the way the credit card companies market and try to sell credit cards to people and induce the use of the credit cards.

While I have some concerns and I'm not in agreement with some of the activities that the companies use, I do have to in part agree with Clint -- this is probably the only time I'll agree with you -- is that I don't know what this APR thing really means.

You asked him what would your wife do if she saw 80 percent APR. You know what she would do? She says, what does it mean? It would be just like somebody telling me you are 150 kilometers away from where you need to get. Well, I don't understand the metric system. That doesn't mean anything to me.

You know, you got to break it down in terms that I understand. What she would be asking him is what does it mean in dollars. Then once he explains it in dollars, then she jumps on him. So she doesn't understand. The other doesn't mean anything.

Now if everybody is doing it, then of course, then everybody is just confused. I don't believe that the consumer would stop using the card because he gets a statement that says my APR is 3000 percent, because the other ten cards that he's holding are going to also have something equally ridiculous.

So I do believe that we can take this thing too far, and it has no relevant meaning to the consumer, because he doesn't understand it. If he's got the 3,000 percent this month, then he says, okay, great, I can now compute next month how I'm going to come up with 3,000 percent, because I'm going back with an APR. I mean with the same kinds of transactions.

He's probably not going to be able to compute it. So what's going to be more relevant, I believe, is actually showing the dollars, like they have done. I don't believe that that number is going to be a relevant number. I really, really don't.

MS. MEEKS: Just a point-counterpoint. That is, I think if the disclosure said your APR is 17 percent, because that's what you shopped for and that's what you agreed to -- So if the billing said your APR without any finance charges is 17 percent, your APR for this because you added this particular kind of charge onto your account, is now 80 percent, I think that is devastating information that the consumer would respond to.

The trigger of that fee, not just the dollar amount, because $25, $15, $30 in and of itself is also not a particularly helpful piece of information in terms of the effect of the rate that it creates on that account, because it is considered to be a finance charge for Truth in Lending purposes.

There are many fees that are not finance charges here. We are only talking about a select few number of fees. There's a bunch of them that are excluded from the finance charge rule, and they have no effect on the APR, you know, on the billing statement. But it's for the select few that Congress and the Board deemed to be important enough that do affect what was the originally disclosed APR.

So I think the consumer would respond to that.

MR. HAWKINS: But, see, please --

MS. McCOY: In the spirit of point-counterpoint, go ahead, Larry.

MR. HAWKINS: Thank you. But, see, along those same lines, if all you had was the APR, if all you had was, okay, if you do the cash advance, it's going to be 80 percent, I think now the consumer is totally in the dark. Says, well, I really don't know what that means.

Then let's say if he went to somebody and says tell me what this means, then says okay, boom, I can do the calculation; it's going to cost you 20 bucks to do that $200 cash advance. I think the consumer would say, okay, thanks, it's going to cost me 20 bucks, I'll do it.

So if you just use that APR, they are going to be totally confused, and that puts them at a disadvantage, I do believe. If you did tell them the fee, now they say I know what it's costing me. See, I don't believe the APR alone, in and of itself, is going to necessarily tell them what it is costing them. They want to know what it's going to cost them so that they can make the decision.

MR. BORDELON: We are a small financial institution. We have three large portfolios with variable rates, variable meaning prime, prime plus two and --

I see an issue for small providers of credit cards. I agree that up front with something similar to the Schuler Box at the top and explaining up front when you're shopping for a credit card, we view, often a very viable alternative. But we are competing with huge credit card companies who have excellent marketing tools, including points and miles and things.

The issue then becomes, one, if we get into a regulatory mode, that we hinder the processing part of the credit card business even more. That's the bulk of our cost.

I think one thing that we talk about is consumer education and member education that we can -- is a real success factor. I agree with Clint. When we say that they don't look at their checking account statement and they don't balance their checking accounts, and that's true. But they do look at that credit card statement.

I think they are not looking at it for an APR or for a fee. They are looking for unauthorized use because we have educated them for that, and we have educated them that they have protection for unauthorized use. So there it is.

Then something else pops up, you know, what is this? What's going on? If you disclose it up front in whatever manner, there it is when you are shopping. Unfortunately, I'm from Louisiana where there's a lot of gambling boats and casinos, and I can guarantee you, a cash advance fee of 50 bucks on some of those does not deter anything.

GOVERNOR GRAMLICH: Yes. Just on this APR issue, a lot of you are in the financial literacy business, and so you must have tried to explain to people what it means when you have the fee and the APR sitting alongside each other, and is that something you can explain?

I mean, I can believe that a lot of people might not understand it if they just saw it cold, but if they had somebody teaching them how to read these things, is that something that is feasible?

MS. McCOY: If I can -- As a teacher, I hate to give up on the thought of trying to teach people, and it seems to me that I wouldn't suggest substituting the historical APR for disclosure of the lump-sum fees. But what I would do is disclose the lump-sum fees and then say this works out to an annualized -- straight off.

Linking the two and explaining that it works out that way, I think, is a very strong teaching device, and it is eminently doable, because we are calculating the historical APR anyhow. Pat?

MR. LIDDY: I think the idea of APR, as you've looked at it in closed and open-end credit situations over the years, have at least made me aware closed-end credit is a very good thing. I mean, I wouldn't even know what to do without it. You got the fees, and you would go to 15 years, you go to 30 years, and you put it altogether, and you match it up and go, okay, that's really cheap or that's more expensive. I think that was the whole point was, as credit shopping tool, Reg. Z allowed us to on closed-end credit use that very valuably.

In open-end credit is where I think -- Having watched it for a while, I really think, even though the idea might have had equal allure in both cases, in open-end credit it really doesn't work as well.

For instance, you drop in, like Clint says, a chart. That's going to be amortized as if it's all -- you know, it's within one month as opposed to a year. That number that you are going to derive out of that depends on whether you have other finance charges that month of a different sort. It's going to have a different number if you've got a different amount of principle that month that's due, and depending on the level of principle that's there.

So what I'm saying is, if you look at it in the open-end context, it doesn't seem to be as valuable on the statement. It's a tool to shop, because it's after the fact. The other thing is it's a number, but that number that is going to be derived APR-wise is going to be different depending on what else is going on at that time. I think the customers can't figure that out.

GOVERNOR GRAMLICH: Could I -- It's not a tool to shop, sure, but it might be a tool that could influence future behavior. Yes?

MR. LIDDY: Possibly. Sure it would be, I think, if they had a recurring payment like in closed-end where it was always the same. But it's different kinds of activity, different kinds of balances.

We talked about, I think, having the consumer box and maybe having another box one place where all the fees were gathered. In one place you could say it, and then at least somebody could go and say how many fees did they have. Well, this guy had 17, this guy had 34. Maybe that's a way to do it. If you're going to take something away, maybe you could put something else in place. Maybe that's the way to gather it together better.

MS. McCOY: Elsie, Buzz and Debra.

MS. MEEKS: My organization, along with Fannie Mae Foundation, actually developed the consumer financial literacy curriculum for Indian country, and I've taught consumer financial literacy.

You know, we can help people understand what APR is and how to calculate it, but I've taught it, and sometimes I can't tell by my statements and, you know, with all the hidden -- Buzz brought up yesterday that some credit card companies have done away with the grace period. So that, you know, if you are a couple of days late or whatever, your APR goes up. But it's just tracking those sorts of things.

I think the other point that was made yesterday by Eric Stein -- Consumer financial literature can go a long way, and we shouldn't give up on that ever. But I bet the percent of people that actually experience consumer financial literacy training education is a very small percent of the people that use credit cards. So it's not a panacea.

MR. ROBERTS: I wanted to maybe build on a point that Pat was, I think, moving toward, and also one that Clint had made.

There are disclosures for the current period of what the fees have been, but how does one place those into some longer time, say annual context? It seems to me, it might be helpful to say that over the last 12 months your total fees for this card have been Y. Then when our wives yell at us, they are not yelling at us just -- They are not letting us off the hook because this month we were okay, but they are yelling at us because over the course of the last year we have paid a couple hundred bucks in fees.

If Oscar is right, that people really pay close attention to what the annual fee is, this is really part of the effective annual fee.

MS. McCOY: Debra.

MS. REYES: I guess my thoughts are that, of course, the fee should be individually disclosed. However, I think that historical APR does give the impact of what you are doing. It's one way to say this is the impact of your action, consumer, and if it creates a question in that consumer's mind, I think that's a good thing; because it does create that opportunity for financial training and ultimately maybe better financial management.

I think the impact of the action is an important event to report, and I think the individual fee does not show the impact of that action to the consumer.

MS. McCOY: Jim and then Oscar, and then Larry.

MR. KING: I guess this conversation -- these conversations remind me of how much education is really needed out there, especially the people we serve. We sell housing. We try to sell affordable housing. The average income is probably around $45,000 in the marketplace where we sell properties for 120.

The issues that you raise here are not the issues that the customer base we serve deals with. Their primary question is can I get a loan. Interest rate is an issue, but only because television says you can get a low interest rate. But if you say to them, I can give you 2 percent greater than, the thought coming through the door, they cannot get a loan anyway. So it's not an issue.

They are a second generation of those people who seek credit cards in most cases. You know, their parents did not have credit cards, because they didn't believe in credit in that way. So, therefore, the issue is can I afford to pay it at the end of the month or can I reach my minimum requirement.

Their spending habits are based on need, or desire in some cases. So the interest rate is still not an issue. And this other issue about the APR is not even on their radar screen. When they get the bill at the end of the month, they look at, as we said, did someone charge something on my account that I didn't get, and can I take it back to reduce my debt that I can't pay.

So I think, to me, new at the table, is that it's been an interesting conversation both around earlier this morning about credit cards -- I mean bounced checks. It's the same issue. The time the check comes to the bank, all I want to be able to do is please pay it, I'll get your money back to you, kind of response.

Again, my issue is this. It reminds me how much we don't know. The population we serve know even less about what we're trying to do to help them. So this is very interesting to me, but I think what I need to understand is -- I need to understand.

MR. HAWKINS: I think, in sort of response to your question, Governor, is that it seems to be a question, will sticker shock deter human behavior. If you look at the history of the country, I don't think sticker shock has ever deterred behavior, and I don't think it will here, and that's all we're talking about.

We say, if we show the dollars but we actually show the APR, the APR disclosed to supposed to essentially be sticker shock. Well, just as Ken said, you know, look at the folks who are down there gambling. I mean you could charge them probably 50 bucks for a cash advance, and they would go do it.

So in response to your question, I don't believe that sticker shock, in and of itself, would deter behavior.

MS. McCOY: Pardon me. Can we first have Dan and then Ron.

MR. DIXON: A couple of things. I guess, if my wife was going to ask me about that big charge on the credit card bill, she probably would have a second question, which would be, well, whatever it was this time, is that the best way to do it next time.

So that gets me back to trying to understand and recall the historical context in which some of this occurred. I assume that the APR was invented as the best device that we could come up with at the time so that customers would have a way to judge what is the real cost of the credit by some definition and, secondly, how can I compare alternatives.

I completely agree, it is imperfect. Even for long-term mortgage-type financing, it's imperfect. One of the imperfections is that very few people actually have loans for 30 years. So the historical, if you will, APR, if they pay off their loan in three years, would not necessarily be all that close to the APR we disclosed to them at the time the loan was originated.

Having said that, I don't know what the next best suggestion would be. If we need to find a better tool to accomplish the objectives, then maybe that is something for us all to work on, but I think that the objectives are still legitimate.

The customer needs to have some good way to understand what the true cost of the credit is and, correspondingly, a way to compare is this the best I can do or is this the appropriate way for me to use credit, versus what are some other choices.

You know, a lot of customers have home equity lines of credit at rates which may be at prime or prime plus six even that they could be using if they run into a situation in which they have unexpected expenses. That would be maybe more economical than overdraft protection or credit card.

Without the way to compare those relative costs, I don't know how consumers are able to make informed decisions.

MS. McCOY: Ron?

CHAIRMAN REITER: I'd like to just build on Dan's comments. Some earlier discussion, some people were saying that the purpose of Truth in Lending was to facilitate shopping for credit, and that's certainly true. But I think a larger goal of Truth in Lending is to give people information about what their charges are, so that it facilitates the informed use of credit.

We all know that APR is an artificial number. It's not just the interest rate, but it also includes a bunch of other things that we have termed to be finance charges, and we've had at times in this Council and, certainly, in prior years debates over what kinds of items should even be included in the term finance charge.

So that the APR is an artificial number, but it is the number that we have all used to indicate what the cost of credit is. The advantage of having this so called historical APR disclosed is that it gives people information about a relationship between the actual charges which they incurred in a particular month and the amount of credit which they obtained.

The issue is not just one of cash advance charges, but there are a whole host of other charges that might come in, in the monthly use of a credit card. For example, if people go over their credit limit, there may be a rather hefty over-limit charge that may be imposed. If people have defaulted on their credit for a month or two, there may be a penalty rate that is imposed that's much greater.

The rate may jump from, let's say, a 7.9 percent APR on a credit card to maybe a 24 percent rate on the credit card. All of that can be seen in that one snapshot, that one month where those charges are incurred. What was the cost of credit that you incurred?

The APR is a very helpful number in indicating to people that -- Kind of like we were talking earlier about earthquakes in California, it's kind of, in a way, a Richter scale. I mean, you know that, if you had a cash advance, if you went over limit and if you defaulted, you've gone off the Richter scale. Your rate has gone from the 7 or 8 percent, has gone to maybe 300 percent or whatever it might happen to be.

It may be a shocking number. But the purpose of it is not just to shock people. The purpose is to inform people that, as a result of their behavior, they have done something which has caused their cost of credit to go up astronomically, and that, hopefully, that will help people modify their behavior so they can engage in use of credit.

I think that's a goal that we should continue to aspire to, and we aspire in a variety of ways, including consumer education. But having the number is helpful.

MS. McCOY: Oscar.

MR. MARQUIS: Well, to take a slightly different tack, I'm not sure that the function of Reg. Z and TILA is to deter or modify behavior. I think the function is to educate and to inform.

So then the question is: Is it better to -- Is it more informative? Does it provide more information if the -- that the APR fluctuates monthly or if it doesn't? Then the consumer knows what the dollar payment is. I think, as Jim said, consumers are concerned with the dollar amounts.

It seems to me the APR is meaningful for comparison shopping, because consumers may not know how it's calculated, but they know if one is more or higher or lower than another. They don't know how it's calculated or what goes into it or what it means or whether it's real or a number we made up. But having it fluctuate on the monthly statement I'm not sure provides any meaningful education.

I think that's the function of Truth in Lending. It's not to modify behavior. It's to educate and inform. Well, as we were talking this morning with check bounce protection or the check bounce programs, a 4,000 percent interest rate is meaningless, but $25 is.

MS. McCOY: Mark, then Clint.

MR. PINSKY: I'm going to see if I can respond to Governor Gramlich's question a little bit in the end, but take this in a little bit different direction.

As I understand it, I mean, the APR -- it is for shopping purposes, but really what it is trying to do is say that, you know, credit card financing, from a credit card company perspective -- it's very complicated. It's very complicated to figure out how to price the risk and how to deal with the different things that happen and, you know, the things that you can't anticipate. It's all part of figuring out risk.

So what you have is, seems to me, a pretty complicated pricing structure, and the APR is to sort of put all that, in some ways -- or the box is to put all that behind the curtain and just say look at this number. Right? I mean, let's make it simple and clear.

You know, it plays a useful purpose, certainly, I think. I think, if I understood Buzz right, I would agree with him that maybe, Clint, the answer to the question is -- or one answer, one possible answer, is to have sort of a rolling average over the past 12 months, you know, a historical rolling average that allows you to see what happened. You could track it on sort of a monthly basis, and you could say, geez, in March it went way up, and that was because I did this thing. You know, I went on a trip or whatever it is, and I was in a bind and I incurred some fees. So that's one way of doing it.

You know, in a sort of perhaps pie in the sky way, wouldn't it be nice if, in looking at that historical average -- or historical APR, you could have something that said, you know, here's why -- you know, a short thing, computer generated, obviously. But here's why, you know, your APR historically over the past 12 months went up; in these months you had these fees, and that's generated. That's an education tool. Right? I think that's probably pretty hard to do.

So another thing is -- more pie in the sky -- wouldn't it be great if there was a way you could say, you know, your historical APR over the past 12 months is this: if you want to understand how to bring it down or how to think about not incurring such high things, call this toll free number, and there is an financial education center of some kind that walks you through that and helps you to understand why it is that that happened and why it is that, instead of being $25 a month, suddenly you are paying an extra $50 a month.

If there is some way of doing that -- I don't know if that is realistic or achievable, but seems like that would be desirable. The goal is to figure out how to translate this into something that will help people making informed choices, be better educated.

MR. WALKER: Great. Thanks. Mark, I'm glad you said that's pie in the sky.

MR. PINSKY: I think that's part of my job here, isn't it?

MR. WALKER: Governor, actually, I wanted to address your question, you know, the education. Obviously, I think everybody agrees that, you know, financial education is a good thing.

One of the questions I thought that your question wanted, though, can the issuer inform the consumer or the card member who gets that charge that month, when the card member calls in and says what is this EAPR thing you got here, why is it all -- it's not what you promised me; and I have listened to those calls, and they are very -- It's a very hard thing to explain.

I mean, I think Elsie said she has a hard time figuring it out. I know I have a hard time figuring that out. I mean, how do you explain it?

In the card member agreement they do say -- and I think everybody does it, but in this one it says, "The cash advance transactions you made caused the Annual Percentage Rate in the billing statement on which the cash advance first appears to exceed the nominal Annual Percentage Rate." You can say that.

But to try to explain it more, how you calculate it and all of that stuff is going to confuse the consumer greatly.

That's my concern. As I think Oscar said -- I agree with him -- you know, the purpose of Truth in Lending is -- and Ron, I think, said this, I think, very well -- is to give information about credit, number one, to shop but also for use, but give them accurate information so they can make their decision.

It is not to change their behavior. That's up to them, but to give them accurate disclosure, accurate information. That's my concern. I don't think it does that. That's my concern with that.

MS. McCOY: Yes, Elizabeth.

MS. RENUART: Just again going back to the education. Truth in Lending is about comparison shopping on one level, but it's not about that on all levels, because, for example, in the mortgage context, you get an early Truth in Lending disclosure within three days of application in a purchase money mortgage loan situation.

So you can use that and comparison shop. But if all we are is about comparison shopping under Truth in Lending, then you wouldn't get a disclosure at the closing, because at that point you are already committed to that loan. You go to the transaction, and you are signing the papers.

Similarly in this situation on the open-ended credit side, it's about comparison shopping with the initial -- I mean with the solicitation and application information, which is very helpful. That's why I was also suggesting that that same Schumer Box be used at the signing of the transaction, just like in a closed-end transaction where you get the disclosures twice. You get them early on when you are applying for the mortgage, and you get them again at closing. But the closing ones are not to shop, because by then you are already -- you've already agreed to open the account.

This particular historical APR only occurs in the billing statement. What you get at the outset for comparison shopping is just the interest rate. It's called the APR, but it's just the interest rate, because nothing else is added into it.

So without belaboring the whole question about why this is so important, which I've already mentioned, I just wanted to give a little bit of perspective and background on how Truth in Lending works, not just for comparison shopping but also to be sure that the consumer knows what they've gotten themselves into.

In the open-ended context, you don't know that for sure with some of -- the effect of these fees until you see that historical APR on the billing statement.

MS. McCOY: I have two issues I'd like to return to. We've had a wonderful discussion of historical APR.

One is the disclosure of the effects of only making minimum payments, which appears to be a major problem. We have close to half of Americans with credit cards doing that.

We have -- In the home mortgage context, we have an analogy which is the disclosure of the total dollar amount that will be paid over the life of the disclosure that is made at closing. I can tell you, time and time again I've heard, and I'm sure that you have, friends who will return from closings, and they will be in shock contemplating the amount of money that they have just committed themselves to pay.

I think that having a disclosure as to how long it will take to pay off a minimum payment, if that's all that you do, and also the added interest charges associated with that, again, may have the shock.

I actually do believe in the teaching value of shock. I try to act on it every once in a while. So that's my first issue.

My other issue is I am deeply concerned about the use and misuse of teaser rates. It just plays on consumers' optimism by getting them to focus on the short term, you know, zero percent or 2.9 percent teaser rate.

Consumers report they are confused, for example, about when the permanent rate kicks in, what balance will it apply to. Will it apply to the outstanding balance or just new purchases? A flood of confusion about that.

There are also reports of very misleading bait-and-switch tactics where you advertise a teaser rate. The applicant calls in to inquire into getting the credit card. It turns out that perhaps their FICO score is not sterling, and they are given a higher interest rate. So I think we need attention to that issue as well.

Are there other comments? The Governors? If not, we have had, I think, a very interesting discussion today of at least three disclosure issues, or four: Historical APR, and what does it mean or not mean; the box disclosures, and having them across the whole spectrum of disclosures; then monthly payment disclosures; and teaser rates.

So with that, I'll close this discussion. Thank you.

CHAIRMAN REITER: Thank you very much, Pat. We would like to turn now to Janie Barrera who will present the Members Forum today.

MS. BARRERA: Thank you. For the next few minutes I am going to speak about micro lending and micro enterprise. We speak a lot about housing issues during these days that we are together, and so I want to focus now on the little small businesses that are throughout the United States, if we can get this thing to run.

So the actual concept of micro lending came from developing countries where you are able to access -- provide access to capital to the poor. So it would be that you would lend somebody in Guatemala, most likely a woman, $25, and they are going to be able to buy a sewing machine, get some material, make some blouses, sell those blouses, pay that loan, and also be able to feed the family and eventually educate that family and take out another loan, and so on, and build enterprises.

So the idea actually came to the United States back in 1991. I think Elsie was part of one of those first groups as well. So in developing countries, the organizations -- actually, the micro lenders actually become self-sufficient between three to five years.

So they start building these micro enterprise programs, and because of these factors, they are able to become self-sufficient, the factors of the cost structure. In a Third World country you can hire a loan officer for about $1,000 a year. You can charge interest rates of 38, 40-something percent, and that's below what a bank would be charging in a developing country.

The other differences would be regulatory. Here in the United States, we cannot go and place our product or service on the street corner, like they can in a developing country. We have to get all our permits, you know, certificate of occupancy, blah, blah, blah, to be able to start a small business.

The marketing strategies are different as well. In Third World countries, you basically -- you know, you tell one person. They go and tell their tribe and their clans and everybody else and is able to get the word out very quickly.

The last thing is the whole idea of market size. There's definitely a have and have not society. So in a Third World country you are either an entrepreneur or you are not, and you are starving. So you've got to figure out a way of being able to put food on the table. So being an entrepreneur is a good way of attempting that.

Here in the United States we have other options. Not everybody is born an entrepreneur. I keep saying -- You know, people ask me, do you think that that can happen, and I say not -- you have to have that kind of passion to want to start a small business or you have to have seen an uncle or an aunt or a grandfather or somebody that had a business to really want to do this.

So the concept was then brought to the United States, and let's see can we do something like this. Why? The reasons are up there on the screen. The whole point of access to capital is so important, you know, because of the reasons we've talked about here. You know, people have bad credit, and if you have bad credit, you are not going to be able to take out a loan from a bank or a financial institution, traditional financial institution.

If you want to start a business, it's going to be a little bit more difficult. So you are going to need some kind of financial assistance. But we see this as a way of breaking the poverty cycle as well. So that we can say that, through micro enterprise, through this whole movement, if you will, we are going to be able to make a difference in the communities in which we serve.

So we created a mission statement that reflects that. We also decide, okay, what kind of product are we going to be offering. So we looked at the niche of $25,000 and under. We saw that those are the hardest for the banks to make, because you are not making any money on those $25,000 loans.

So we also knew that there were other lenders, nonprofit and other kinds, that were out there making those larger loans. So we chose that niche. When we talk about behavior, we wanted to say, okay, how are we going to set up the program so we do try to at least change some kind of behavior.

So we have no grace periods. If your debt payment is due on the first, it must be paid on the first. So it's not confusing to them. So we are able to say, you know what, this is it. And if you do pay on the second, there is that interest rate that you are having to pay.

The interest rate that we offer is between 12 and 14 percent, 14 percent on the very first time loan. On the second loan, they are able to -- if they've had a good payment record with us, it's lowered down to 12 percent. Most of our customers have loans for about -- you know, three or four loans during the time they are with us, before they actually graduate into a bank.

So we started in 1994 with a dream of wanting to become a micro lender and getting the 501(c)(3) and everything else going that you need. Now we have assets at the end of the year of close to $11 million. We have 40 employees, and we've been able to raise grants and debt to be able to accomplish what we need of $8 million and almost $8 million as well in debt.

We've distributed over 4,000 loans since 1994 with about $21 million out in actual funds. We have over 1,300 clients and an active portfolio of about $7 million right now. All of these loans -- the average size is $5,000. So these little baby loans that we are out there doing, and the loss rate is less than 5 percent, which again means that folks need access to credit, and they do want to pay it back, because we are their last resort.

Our competition is the pawn shop, is the finance company, is all the folks that are not able to have the same kind of heart attachment that we do in terms of wanting to help the community.

So we report back to the credit bureaus, actually, their credit history with us, so they are able to establish or reestablish their credit.

The reason we were able to get into the whole State of Texas is we use a technology that we found from the banks, the banks who were doing the back room operations in New York City. So what we decided, okay, we'll do the back room operation in San Antonio, and have satellite offices in these different cities throughout Texas.

So now we have real, live people in these cities, and we are able to work in 200 additional communities because we have a partnership with small development centers, chambers of commerce or folks that actually can see the people.

We are still in the laboratory stage, because the whole idea or the concept of micro lending was that you would build a relationship with the person, and they would want to pay you back because, you know, you said okay to me. I took out this loan with you. I'm not paying back ACCION. I'm paying you back.

Well, we are experimenting in this other arena of the other smaller communities, because our loan officer actually sees them, because the chamber of commerce person actually sees them, and it's breaking that myth that we thought that that was going to take, but guess what. Their portfolio is just as good as the rest of the people that are in the urban areas. So that was a lesson learned for us.

We have also closed a couple of offices down, because the volume was not there. Once you've reached 50,000 people in an area, the volume was not there. So we had to close this -- went ahead and closed up, and we service those out of a central office in San Antonio.

What we are trying to do is reach scale. We are trying to see can that be done in the United States.

As you can see, in 1998 we see the dramatic growth in production, and that was because of our satellite offices and our loan officers, and I call them l-o-n-e offices, are out there being our sales people. They are bringing people in to be able to do the processing in San Antonio, and then we disperse the stuff back, and they actually close the loans.

What we have also learned after four loans is that 54 percent increase their take-home pay. Forty-seven percent grow into their business process, and 42 percent grow in business assets. These again are from that small amount of money that they are taking, using as working capital, paying it back, and building that small business.

When we do the underwriting, it's not going to be on the business information alone. We take a whole family, the kids, the grandparents that may be living there, everybody, to make sure that we are able to sustain that loan some way.

The collateral we take, 100 percent of that loan has to be guaranteed, but it's not going to be guaranteed by the traditional, you know, CDs that some people may have. It's going to be with computers. It's going to be with maybe some inventory that they may have.

We also have -- We had a woman who wanted to buy some -- some goats. We took them as collateral. Eventually, we were able to sell the asset. She needed to pay on her loan.

Juana Perez is another example of a woman in the colonias, and actually she was in Christian Science Monitor. She was featured -- her little story is featured there in the business section. Does not read or write, but she knows numbers, and she wanted to expand her business. It was a grocery store in the kitchen of her trailer home, and she sold, you know, what we call Jello for 50 cents, 25 and 50 cent containers of Jello, toilet paper, you know, those kinds of things.

She came and asked for a $500 loan, paid that off, built her inventory, took out a cash register so at least she could take care of adding up what she was selling. Then on her second loan what she did was she took out about a $1,200 loan, and this time put a carport onto the trailer house, a picnic table, and told the kids they had to eat outside, not inside the house.

The third loan was about $3,500, and now she is building, as you see, back there -- in colonia you don't have to have any kind of permission to build anything. So she built herself a little building out there, and now she sells Yo-Yos and bicycles and has a refrigerator there for her milk and anything else that she sells.

I was talking to her the other day, and she said, you know what -- she said, yeah, other women opening up shops in the neighborhood, but I've got an advantage that they don't have.

That advantage is that I'm legal. I go and I get my permit now to be able to have my shop, because I realize now that, if I have a permit from the city, I can open a shop, and they are going to close them down.

She also wanted a $100,000 loan so that she could buy this building that she built. So I told her, well, we'll talk about it.

We've been learning all these eight years about credit, accessing credit and the importance of it, but now we are thinking about -- access to credit alone is not going to do it. How is that going to be building wealth in communities.

We are able to get some funding from HUD where, for every dollar someone saves, they advance $20. So we looked into the business plans of theirs, very, very simple.

The financial literacy part is helping to keep books. What do you mean by keeping books? What we mean is a ledger to write down how much money do you spend, how much money do you make, and keep it on a weekly basis. They have to come and visit with us and bring it in.

After a month, we are going to put the financials together where after a year you are actually going to have a balance sheet to be able to show that you have assets. Now they are able to show assets.

When Governor Bernanke and Governor Bies were down in the Valley, I mean, there was -- You can see first hand the little video store that you went to visit -- I mean, he was very -- You know, he was looking at the whole business perspective and saying, you know what, this is a good deal for me, because there is no other video store. Blockbuster's was, you know, miles and miles away. They can come in here and do business with me.

He had the whole thing set up about, you know, if you don't bring -- how do you -- Reacting to the question, how do you manage when somebody doesn't return a video, say, and he was saying stuff like, well, they have to come and actually drop it off; we have no slots in the door. They have to actually come see me and drop it off, and if they don't, I'm going to go out and find them.

So examples like that -- I mean, it's really -- It is relationship building.

The other thing, too, is now they are having to open a bank account. Before, that was not even an option. The closest, Nicalonia and El Paso, for instance -- the closest bank is 25 miles away. So for them to get there is a chore. But it's worth it to them to be able to get this match, dollar for dollar.

Now what are they doing? They are getting these statements once a month that say that their money is -- this is how much money this month. They may only save $1,000, but can you imagine having $1,000 and within a year you're going to have another $1,000. So that's what is really exciting for us to be able to do.

Our goals are to become self-sufficient. We are still trying to do that. The outstanding portfolio is $7 million. We think we can be up to $14-$15 million.

So we are trying ways of figuring that out, because again the cost structure is a little bit different. We want to be able to have a statewide impact, which means more than making that 1,100 loans a year.

There are some credit organizations, by the way, that are more in depth in that they work with people like for months and months, and they make maybe six or ten loans a year, but that is their goal to do that. That is what their mission is to do, is to work with individuals and really work with them one on one.

Ours is, as we said, breadth. How many people can we reach? How can we reach them? So those are things that we are trying to grapple with in terms of being in a laboratory.

I close by this. Knowing you all, you all work with credit -- That's what we are doing, right, or we wouldn't be spending our time here either, even though we love being here the times we are here, but we are also committed to what we do and being able to share information.

So with that, any questions?

CHAIRMAN REITER: What criteria do you use for lending?

MS. BARRERA: It has to be legal. You have to be over 21. You have to have a commitment to the business. If it's a truly start-up, you have to have some other source of income, which means a spouse or grandmother or somebody who is going to be able to pay that loan if the business does not succeed.

That's basically it. I mean, you have to -- It's very simple in terms of how much money do you make, how much may you spend, what do you have at the end of the month to pay the loan.

MR. GARNER: Then I guess a follow-up, how do you then price? Do you use a --

MS. BARRERA: Well, of course, everybody thinks the computer is worth $3,000. Right? Only in price alone, not the --

MR. GARNER: Just the loan. I'm sorry.

MS. BARRERA: Okay. Well, we've actually had a lower -- We don't to be usurious, right. So we started at 16 percent in terms of what we were offering the customer, and we've lowered over time, because we've been able to build our equity base, because we are trying to be -- you know, as a nonprofit organization, be self-sufficient, but at the same time be good to the consumer.

So that's why -- like our budget is $3 million a year. One and a half million comes from the revenues of the loans, and then the other million and a half I basically have to go out and fund raise for.

MR. LIDDY: Are you Texas only or will you go to the other side of the border, too?

MS. BARRERA: There is a New Mexico -- We have like sister organizations. We are separate 501(c)(3) organizations, and there's already an organization in New Mexico. It's based out of Albuquerque.

There is one in Chicago that serves the area of Chicago, one in New York that serves the burroughs, New England. They have just opened up one in Atlanta. There is one in San Diego and in Miami.

MR. LIDDY: Have you gone to Mexico yourself?

MS. BARRERA: Mexico, no. Oh, no, we stay within our own --

MR. DIXON: What is your source of lendable funds? Do you have --

MS. BARRERA: We have -- Our cost of capital -- the most expensive is 4 percent, and we get those from banks. We also get religious congregations that will invest in us at 1 or 2 percent, socially responsible investments.

We also get actual PRIs from foundations. We will get actual grants to do -- for direct lending, and then -- So there's really three parts of money, grants that come in for operations -- so that gets spent; grants that come in for lending that can only be used for the lending pool; and then our debt.

CHAIRMAN REITER: What kind of collection effort do you have to engage in?

MS. BARRERA: When we go out and collect and we bring the inventory -- we become the proud owner of whatever inventory it may be that we have as our collateral. Instead of boxing it up and selling it to somebody for 5 cents on the dollar, whatever you may think would be great, we'll open up shop.

So we -- Actually, right now we've got some clothes that we are selling. Last year, actually, we had an auction. We had a festival, if you will, and had a silent auction and invited the community to come in and buy what we had. Of course, you know, we wanted the higher bid. Then we directly take that against the loan of the person.

So what we are trying to do is to lower the amount of the loan, so that the person is not having that big of a charge-off. And in some cases, we get 100 percent.

CHAIRMAN REITER: Do you have to call people lots of times?

MS. BARRERA: Oh, gosh, yes.

CHAIRMAN REITER: Do a lot of hand holding?

MS. BARRERA: It's not any different than your life. I mean, you know, we've had to go use a pay phone, because nowadays everybody has caller ID. So instead of --

MR. FITZGIBBON: Just as a question, you talk about banks as investors at this point. Are there opportunities for expanding the banks' role in partnership lending or things of that nature that will, in effect, sort of build on your -- the strength of your network and delivery system and tap into other capital?

MS. BARRERA: You mean as in tandem loans?

MR. FITZGIBBON: Tandem loans or actually direct --

MS. BARRERA: As long as you would look at our paper as okay, because, see, that's where we have difficulty, is because -- I was joking last night, but I was serious. Our paper is XYZ paper. Every customer is 100 percent nonbankable. So how can you take your underwriting and say, you know -- you're crazy. Why would you make this loan? We've got to figure out a way of doing it.

MR. FITZGIBBON: What you are saying in a lot of cases is that this is -- you got someone who comes the first time, the second time, the third time, and by the third time -- So how do you graduate them? How do you then get them shuttled off into the mainstream?

MS. BARRERA: by that time, they are much more educated, and they are ready to go into a bank loan. So we will let bankers know that they are ready. Actually, bankers will call us and say, you know, are they ready.

There was a man who got a $750,000 loan who started out with a -- He is also -- I guess he wasn't. But he started with a $10,000 loan with us three or four years ago, and he just got a $750,000 loan to be able to build his warehouse. He does -- He takes pictures of medical histories and needed a place to store them.

So there is that way of, you know, moving people along through the process.

MR. ROBERTS: Some micro lending programs have these circles of followers.

MS. BARRERA: Peer group lending.

MR. ROBERTS: Peer group lending. Do you do that and, if not, why not?

MS. BARRERA: Actually, we were talking about that yesterday. When this movement came into the United States, that's what it was. It was a peer group lending model, because that's how they do it in Guatemala or in Africa or wherever it may be.

Peer group lending model is the three of us get together and we take out X amount of dollars, and we kind of co-sign for one another, if you will. So if for some reason I cannot pay back my loan, then you two have to figure out a way of paying back that loan.

So there was a way of, you know, checks and balances in that. So when we first opened up ACCION, we -- and actually we still offer that as a product. But you know, you look at me -- They would look at us like we had two heads, wanting to co-sign for somebody I really don't think that they are going to be able to, you know, all that kind of stuff.

So what we have found is that you can use it as a product for like cab drivers, because it's already a subculture of their own. They know where they hang out and so on, or Mary Kay cosmetics, because they already have their rah, rah meetings every month anyway.

So they have already built community. It's only where you really have this true sense of community, and you keep these loans low. That's the other thing, too. We don't allow any peer group lending to go over $3,000 individually. It's too big of a burden.

By that time, they should -- After that amount of money, you should be able to stand on your own to be able to take on that. But I think that's one of the reasons some micro lending organizations in the United States failed, because they didn't look at the market.

The market in the United States is totally different than in the developing countries. You can't run a program like that, and I think that's one of the reasons that we grew as quickly as we did. We've become the largest micro lender in the United States, and it's because we were listening to the market and what you need; because the other -- Quickly, the model that's used in developing countries is step lending.

The maximum amount of a first-time loan is $1,000 or whatever that may be. So that's not a product that people needed, you know. So what we'll do is the policies changed, so that we'll do a first-time loan up to $25,000. That's not very often, because they don't have the capacity to pay back. But we'll do a first time loan up to $25,000.

Well, thank you all very much.

(Applause.)

CHAIRMAN REITER: Thank you very much. Our meeting is adjourned. At one o'clock, the Council members will come for lunch. I'm sorry? Oh, I'm terribly sorry. I'm sorry. I forgot one of the most important parts here, and that is the committee reports of upcoming events.

Why don't we begin, Earl?

MR. JAROLIMEK: Sure. The Community Affairs and Housing Committee has set up some topics for the June meeting. We might call this predatory lending, Chapter 2. Again, back to our earlier comments, we are hoping to take on another narrow focus of predatory lending, try to get some more substantive information from that.

So the area we have chosen is successful alternatives to predatory lending. What we hope to draw out here is somewhat of an overlap into the financial literacy topic, which is an area that we've talked about in our committee before.

Successful alternatives may be education, financial literacy, and it may be some programs or efforts that have already been proven to help meet credit needs, in effect steering people away from predatory lending. So we are going to talk more about that. That's kind of our highlight for next time.

CHAIRMAN REITER: Thank you, Earl. Buzz.

MR. ROBERTS: In the Compliance and Community Reinvestment Committee, we plan to talk about two things. One is how it would be possible to make disclosures and perhaps other aspects of regulations more effective for both consumers and banks, simpler, clearer, more consistent and less costly.

Second is that we wanted to take another look at the Community Reinvestment Act service test.

CHAIRMAN REITER: Thank you. Pat?

MS. McCOY: Yes. In Consumer Credit yesterday we discussed two additional topics. One is the interplay between HUD's proposed guaranteed mortgage package proposal under the Real Estate Settlement Assistance Act, and the interplay of that proposal with Truth in Lending Act disclosures.

The other topic we discussed was the proper treatment of what I call keychain credit cards. These are unsolicited alternative credit cards with new technologies, and how the unsolicited receipt of those should be treated under the Truth in Lending Act.

At our next committee session in June, we plan to discuss issues raised by the Fair Credit Reporting Act reauthorization, telephone billing for consumer purchases under TILA, variable rate disclosures for home mortgages under TILA, and convenience check disclosure.

CHAIRMAN REITER: Thank you. Oscar.

MR. MARQUIS: We had an extensive discussion of the U.S. Patriot Act and Section 314(a) dealing with the sharing of information by financial institutions with government agencies and how problems have arisen because government agencies seem to indiscriminately be requesting information on a large number of individuals, and financial institutions have to dedicate personnel to do background -- to check their records. Often, the urgency isn't really there that the agency says there is at the beginning.

Then we had an extensive discussion of the check bounce protection issue, which we -- We didn't rehearse it, but we did a reiteration of that this morning.

For the next meeting -- Oh, and we also -- We heard about stored value products and Regulation E, the applicability of Regulation E to stored value products, and the draft regulation that was issued in '96, I believe, which we learned now is probably going to be withdrawn, and we'll get something new.

So at the next meeting, we plan to discuss the stored value issue again to see if there are any further developments, and further discussion of the USA Patriot Act and how implementation is going along.

CHAIRMAN REITER: Very good. Thank you. I guess now, no further business, we will adjourn the Council meeting and Council members will gather together in a few minutes for lunch. Thank you very much, all.

(Whereupon, the foregoing matter went off the record at 12:58 p.m.)