TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING
THURSDAY, OCTOBER 23, 2003

The Consumer Advisory Council met at the offices of the Board of Governors of the Federal Reserve System, Washington, D.C. at 9:03 a.m.

Members present:
Ronald Reiter, Chair
Agnes Bundy Scanlan,Vice Chairperson
Anthony Abbate
Kenneth B. Bordelon
Susan Bredehoft
Constance Chamberlin
Robin Coffey
Dan Dixon
James Garner
R. Charles Gatson
Larry Hawkins
Earl Jarolimek
W. James King
Patrick Liddy
Ruhi Maker
Patricia McCoy
Elsie Meeks
Mark Pinsky
Elizabeth Renuart
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 Gramlich, member, Board of Governors
Susan Bies, member, Board of Governors
Ben Bernanke, member, Board of Governors

C-O-N-T-E-N-T-S

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

(9:03 a.m.)

CHAIRPERSON REITER: Good morning and welcome all and a special welcome to Governor Bernanke and Governor Bies and Governor Gramlich. Welcome, and this is a graduating meeting for the graduating class of 2003. A number of members are rotating off the Board, and they are Anthony Abbate, Manny Casanova, Connie Chamberlin, Earl Jarolimek, Pat Liddy, Oscar Marquis, Elizabeth Renuart, and me.

And I think I can express for all of the departing members a great deal of gratitude to the Governors and staff for the opportunity of being able to serve on the Council. It has been an amazingly enlightening experience for all of us personally, and we hope we have contributed to the work of the Board and have provided constructive, although often conflicting, advice on various matters.

I also would like to particularly acknowledge two people who make the Council work: Tina Featherstone, who is standing over there, and Ann Bistay, who is seated in the middle in the back. Their work is outstanding in making the Council function, and I think we are all very, very appreciative of everything that they've done. They are truly sort of the backbone stage managers and have really put programs together and done a marvelous job and have provided a great deal of support for all of the Council members.

(Applause.)

CHAIRPERSON REITER: I might mention just to Council members that you have a black folder that's at your desk, and that contains a variety of information, including the schedule for the 2004 meetings.

Well, we'd like to begin our discussion today on the issue of funding and long-term sustainability of nonprofit organizations, and I'd like to turn to Earl to lead the discussion.

MR. JAROLIMEK: Okay. Thanks, Ron.

The Community Affairs and Housing Subcommittee met yesterday to take up this issue. More specifically, the discussion focused on the issues related to long-term sustainability and innovative programs to counter declines in operating income or funding, and we had a pretty good discussion yesterday about, first of all, trying to gauge the scope of what we wanted to talk about, who really is affected, and we identified, in addition to CDFIs and

CDCs housing counseling agencies as well, and there may be others which I hope the committee mentions. But there are others that rely upon funding sources that increasingly are not readily available.

We want to make sure that we as a committee identified the fact that the partnerships that these agencies or groups have with financial institutions is really essential to many of them in providing a source of loans, particularly with housing.

So we started to talk about some of the problems that have already been identified. Some of the things that we see are those maintaining portfolios, particularly CDFIs, are exposed to rate volatility, and in some cases some of the expertise in managing that portfolio is lacking.

Many of the organizations are operating on a mission model as opposed to a profit model, so that provides some unique challenges in and of itself.

Lack of new money makes it more difficult to mitigate yield curve effects. Other issues that were brought up as problems include cash flow, interest expense from borrowing from other nonprofits, diversification. They oftentimes have a very narrow focus. Even market competitiveness with other nonprofits and for-profit lenders.

And finally, someone raised the issue of greater increase of cases of fraud in some of these organizations.

So we started to then talk about some of the solutions. Some of those brought forward included diversification, capital pooling, income sources, trying to identify other sources of income other than perhaps government funding, standard measures of success similar to what a financial institution might experience in a safety and soundness test or exam, government funding, of course.

And then we started to turn the discussion into what policy may be considered to help these solutions move forward, including looking at how the CRA investment test may play a part here with regard to this; some of the messages that the Federal Reserve may help send, particularly with, you know, the focus of recognizing the essential ingredient that they are for so many financial institutions in providing a source of loans.

So with that, I would invite the Council to take up the subject and begin to discuss further some of the problems, solutions, and suggestions we might have today. Who would like to start the discussion?

Yes, Larry.

MR. HAWKINS: Well, I will if nobody else will. You know, one of the things that we noted was I guess we first asked ourselves why are these organizations here and are they necessary. I think we concluded that they are necessary.

But what realistically can we anticipate and expect from organizations that were formed to do a very difficult task, to deal with a group of individuals who essentially aren't banked, who have very little resources and have some real challenges?

So when you're dealing with that kind of base, what can we expect in terms of your ability to be profitable? And we talked about how difficult it is for a lot of the banks to be profitable in today's marketplace.

That being the case, I think we also sort of concluded that we do need to anticipate and expect that there's got to be some continuing other funding sources, whether it be government or other entities.

In difficult times, the money dries up from foundations and some of the other traditional sources that these agencies would get funding from. So when that happens, where can we turn? Where should we turn to look for some funding to help prop up these organizations?

And one of the natural places was government. So we're hoping that we can find a way that you good people can open your hearts and pocketbooks to help fund these.

(Laughter.)

MR. JAROLIMEK: Elsie and then Mark, please.

MS. MEEKS: You know, I think we started off the discussion yesterday saying, "Why is this an important topic to discuss here?"

And you know, coming from CDFI, running a CDFI, and now helping tribes, government has set aside money for tribes to start these CDFIs. So this is really of concern, the operating environment right at this time.

But Buzz made a really good statement yesterday when he said, "Look. You know, we went into these communities because the banks weren't doing it. They couldn't do it, and we started lending and we did a really good job of getting people prepared to borrow, and now, you know, a lot of the loans we're making now are going to the sub-prime lenders. The banks have figured it out."

And that doesn't mean that there still aren't communities and that we still don't have customers in these same communities whose credit needs aren't being met.

And so, you know, whether we're reaching lower into the community or at a deeper level into the community, I mean, of course, there's more people coming in, but we play a very important role.

And you know, we've had the opportunity in the past to, you know, fall back on foundations when government contracted and vice versa, but you know, this particular point in time both are contracting, and so it really does, you know, leave a lot of the CDFIs in a precarious position.

MR. JAROLIMEK: Thank you.

Mark.

MR. PINSKY: Well, one of the things we used, and you all have this in your packet with some CDFIs and how they've been doing, we've been watching the performance and the impact of the economic changes on CDFIs for three or four years now pretty closely, and one of the good things is that I think that CDFIs have sort of weathered the economic downturn fairly well or better than we might have expected in some ways.

I think one of the challenges that CDFIs face, and I think it's probably true for CDCs and perhaps other nonprofits as well, is that they've been perhaps too slow to respond to the recognition that, in fact, what's happening creates structural change and it's not just sort of can we weather this storm.

And so I think that one of the things that we identified was that there's going to be sort of a transformation in the way a lot of these nonprofit organizations work and they operate, and there is going to be some consolidation, and there is going to be some changes, and not all of that is bad.

I mean, there's some of this that probably needs to happen. I mean, it's a market force at work, and it's not a bad thing, but that we need to be sort of intentional about what we're then trying to grow out of that and where that leads to.

You don't want it just to happen without a sense of it, and so I think that there's a need to really focus on how do we sort of rethink the business model and how do we rethink some of the partnerships that exist between banks and other financial institutions, between government, between nonprofits, and that's an important discussion to sort of have as we try and map this way forward.

MR. JAROLIMEK: Connie.

MS. CHAMBERLIN: Thank you.

And I think one of the things that we all agreed on was that the various nonprofits that have been mentioned are all absolutely essential in making it possible for banks to lend in lower income communities. A lot of the people that we deal with are not only financially illiterate, they may be actually illiterate.

In one of the cities in our service area, 43 percent of the adults are illiterate. That's just a phenomenal number. That's a Third World number, and trying to deal with communities like that obviously is going to take a tremendous amount of time.

Tommy, I guess, isn't here today. Yesterday he talked about developing long-term customer sustainability, and that's talking about working with somebody from the moment the thought of a loan is sort of a glimmer in their eye until years past because these are people who may not have much in the way of cushions. They are going to need not only pre-purchased counseling, they're going to need post purchasing counseling. They are in some cases going to need default counseling to help maintain those loans, and all of this is phenomenally expensive.

One of the things that was discussed yesterday in the meeting is that state and local funds contracts are now moving toward payment on delivery of service, and that creates a couple of problems.

First of all, if the person does not actually end up with a loan, and many, many people don't, you may never get paid for the service at all, and secondly, it creates an enormous cash flow crunch, which also has costs when you have to borrow money to cover that cash flow.

You can't always build this into the cost of the loan or, if you're a CDC, the cost of the house. One of the things we find that it takes, and this is really a minimum number, approximately $4,000 to get one person into a loan, and these are going to be good loans. The people who go through our programs have a very, very low default rate, less than one percent, and they are actually not going into sub-prime loans either. They're going into prime loans, but it's very, very expensive.

And you obviously can't ask the borrower to pay this if they start out with minimal amounts of money to begin with.

So I think that you hear everybody talking about the importance of housing counseling, but nobody is willing to pay for it. In Virginia, one of the things that we've seen is that with the bank consolidation and the banks all leaving Richmond for North Carolina, their money is going with them. They have no interest in supporting the community where they are no longer headquartered.

And this is not just true for CRA types of support. It's true for community support generally. So that's been a particular problem that we have had.

And I think ultimately, you know Larry sort of put the real issue on the table. But if you believe in this and everybody talks about financial literacy, everybody talks about consumer education, if you believe in it, somehow you're going to have to find the money to do it, otherwise it's not going to happen.

MR. JAROLIMEK: Thank you, Connie.

Buzz.

MR. ROBERTS: There were at least three roles that nonprofits play that I think support profit financial institutions do in communities. One is a market priming function so that nonprofits improve communities to the point where there were more business opportunities for the for-profit lenders.

Second is a research and development function where nonprofits are developing really new products suited to these customers and communities that then fill gaps and in some cases the for-profits can come in and build off of.

And third is co-financing, particularly where the nonprofit roles often take a smaller and, hence, less efficient piece than the for-profit or take a higher risk piece that will create a manageable risk for a for-profit partner.

Most of that is complimentary. Some of it at the edges gets to be competitive, as the realm of for-profit activity expands, which is a good thing. There are edges where there is a competitive situation between the nonprofits and the for-profits.

But I think overall what this means is that the nonprofits are doing the work that is inherently not profitable, and that does get to the question of, okay, well, if it adds value but it's not profitable, who pays for it, and I think one of the things that we've seen is that the more effective ways of doing this are to look for ways in which the for-profit sector and the nonprofit sector and the public sectors can agree on a way to do that together so that you do get some discipline in the process and accountability in the process that sometimes is harder to achieve solely with the government being involved.

But everybody understands the roles that each sector plays in the equation and is willing to put a little something on the table.

MR. JAROLIMEK: Thank you, Buzz.

James.

MR. KING: Yes. Buzz is right. The role that CDCs particularly play in neighborhoods are those roles, but the problem with those is that they are so broad. The Community Develop Corporation can get caught in this who are you today kind of syndrome.

If I talk to a banker, they're talking about return. I mean, that's their return on investment, return on the product we deliver.

If I talk to my community council or my community groups, they're saying, "What are you doing holistically to change my neighborhood?" which includes the banking part of it, grocery store part of it, all of the things we need to do

And then there's the group who says we need more data about your community, and there's a planning component we have to do because it's not given to us by the city in a direct way that affects that particular neighborhood.

And then there is the funder who says, "Well, there are too many of you out there. You need to consolidate."

Well, now if you believe the community based kind of development, that's not just a thing to do. It's a process you need to go through to get other neighbors to buy into you being that person.

And then there's this thing about who pays for all of this. Well, the only one you get paid for is production of a product called a house in most cases. All the other stuff you do because you have to do it.

And what we are finding now is that the funders are saying, "Well, if we were to have one process that we all buy into," then may be we can fund you to do work in all communities."

Easily said. Reduce the amount of money given to us, but the responsibility now is enhanced to seven different communities having to do the seven different things in different communities.

The product at the end of the day is that we still can't afford to do it. All of the neighborhoods we work in, we do the things with an outline, but at the end of the day, we are subsidizing everything we do, everything we do. Everything we do is subsidized. So at the end of the day, how do we get paid to do that?

And CDCs are having a real difficult time now in going back to their traditional funding sources and saying, "Here's what I can produce," because we're asked to do so much that it's getting very difficult.

MR. JAROLIMEK: Yes, Agnes.

MS. SCANLAN: I actually just have a question for you, Earl, and for the committee. I didn't sit in on this committee so I wasn't part of all the discussion, but in listening to what you were saying, James, and also looking at just the whole world of merger and acquisitions and the fact that over the last ten years many banks have merged, in our community in Boston, we used to have 12 banks. Now we might have three major ones.

What is the strategic thinking of the community organizations and even the banks specifically on this factor that you used to have may be ten areas of resources and now you only have three?

And it is no longer traditional, as you just said, James. What is the new futuristic or strategic thinking of a community group about this, about what you're going to do? And then specifically, what is the strategic thinking about what some of the banks are doing to help address this?

MR. JAROLIMEK: Yes, James.

MR. KING: We are testing a model in Cincinnati where we are contracting services out to other groups, trying to maintain communities' grassroot kind of process where there's a board of directors who represent their community, but they contract all of their staff out to one organization.

The decision process is the same that they go through to get decisions made within the neighborhood, but the implementation strategy is that another nonprofit provide the resource to get it done.

It's a process we're trying to work on because we're trying to get like communities within a changed geographic district to work together, but it's not easy because we still believe that this is my neighborhood and I should be in control of my neighborhood, and we taught people to do that. You know, that came out of the '60s. You know, this is your neighborhood, and you should take responsibility for your neighborhood, and they are taking it seriously.

So there's still a lot of miles that are trying to be tested.

MR. JAROLIMEK: Agnes, I'll try to give a banker's perspective, and then I'll turn it over to Mark.

We have experienced in our organization tremendous consolidation. We used to have at one point, I believe, at a high 28 bank charters that made up our organization. Now we have one, and that didn't happen overnight. It was sequential.

But when it comes to CRA, one of the things that we felt was imperative was that, you know, while the data might be managed centrally and while the analysis might be done centrally, the outreach to the communities, the relationships that have been established when there were 28 charters, you know, working each with an independent CRA exam; when it came to one CRA exam, we didn't try to do everything centrally.

We make a point to have the communities touched by our branch staff to make sure that those relationships continue, and there is a lot of this consolidation and collapsing of charters in the industry, and I think there are other models, peers that I've talked to who have tried to achieve that same level of communication even though they have changed structure.

Mark.

MR. PINSKY: Yes. Agnes, it's a great question, and I think it is what everybody at least in the CDFI world is sort of trying to think about now. What's the path forward in some ways.

And I think what Jim said touches on part of it, which is I think that there needs to be sort of a measure of efficiency brought to what nonprofits or what CDFIs at least -- I'll speak for CDFIs -- and part of that means that you don't have, you know, so many sort of small, vertically integrated companies anymore, right? You need disaggregation of function, and then you need sort of an integration across an economic line in some ways.

And so some of that happens on a local community where folks are going to start out-sourcing functions that they used to do themselves and perhaps be less possessive and hopefully less competitive about what they call their own.

And I also think it needs to happen at the national level, and I think that instead of having every CDFI going out and capitalizing itself in small ways to do the same things in nine different places, that I think, in fact, you may see opportunities for larger aggregation of capital and you start looking at different liquidity means and even securitization of secondary market activity.

So in some ways, we think that the CDFI industry has to learn and will learn from what conventional financial services have gone through over the last 20 or 25 years, right?

And I think that, in fact, that creates opportunities for some partnerships because, in fact, some of the things that CDFIs do today and perhaps they shouldn't be doing; perhaps a bank should be doing in their partnerships, and banks are certainly more efficient at doing some of the things than we do.

And so, you know, those are just some of the elements that I think sort of end up realigning how capital flows into communities in some ways, and I think, you know, to the extent that I think that a lot of CDFIs which are almost without fault primarily portfolio lenders may no longer be lending to their own portfolio. They may be lending to bank portfolios or to other CDFI portfolios.

So I think it's going to result, you know, in significant restructuring. Those of you who have been through it probably could teach us a lot about how to get there. You know, we think we need to get there in three to five years, you know, and so we need to learn from those who have been through it in some ways.

And I think it's starting to happen as Jim talked about in the CDC world. We see it in the CDFI world. These things are starting to happen because they have to because, you know, the economics of the world we live in today are forcing them to happen, and I think that's going to be a good thing in the long run. I think it actually will enable the CDFI industry to operate at a scale that it's never really been able to operate before and also to redefine its relationships to banks and foundations and government in key ways.

I hope that kind of answered a little bit.

MR. JAROLIMEK: Robin, Charles, and Ron.

MS. COFFEY: Yeah, I wanted to pick up also on what Earl was talking about when you talk about bank consolidations or whether as bank mergers have happened. The other thing that's becoming more difficult that I see as a CRA officer, as we do still maintain multiple charters, is trying to maintain leadership positions within our communities, and that's in terms of having our branch personnel or having our lenders who are actually working in these communities staying in touch with these communities.

One of the things, the other byproduct of a lot of these mergers and acquisitions is you're losing people, and what I find is when we've left a community, it's primarily because I no longer have that involved person anymore, and trying to get somebody else within a bank or within anywhere these days to pick up additional responsibilities is increasingly difficult.

We're asking our branch managers. We're asking our community affairs people within the banks to do more and more, and they're essentially tapped out like everyone else.

As you are also looking at decreasing budgets, you're trying to make sure that the funds you are giving out, whether it's in grants or investments, are also producing some type of return back to the bank, and primarily you're looking at are you getting loan volume from it. Are you maintaining the contacts? Are you building some kind of pipeline?

You're not so much looking at profits, but are they delivering something that you'll eventually have a connection with later on? And that gets back to, okay, so who do you have at your bank who's actually involved in this group to make sure that services will be provided?

And as you're losing people, you're losing contacts with a lot of these communities, and I'm sure that's what's happening in Richmond, too. It's not so much that, you know, there's probably no banks headquartered there anymore. It's also, I'm sure, a lot of the people that you originally dealt with are also gone.

MR. JAROLIMEK: Charles.

MR. GASTON: Well, Jim talks about changes in industry. Your question is about what do you do, what's happening in the CDC industry. That's where I'm from.

CDFIs are, you know, kind of mysterious to me, but CDCs aren't. From a personal perspective, an organizational perspective, three years ago we embarked upon looking at who we are, what we were trying to accomplish. We spent money doing that, and we had LISK (phonetically) locally spend money doing that, doing an evaluation of our organization, what we're accomplishing, what our weaknesses were.

I'm not one to actually look at my weaknesses too often, but we did look at them, and we were very serious about it.

We additionally spent money with a consulting firm, PKD, which is a CPA firm, to look at our business practices, how we did what we did and were we being successful at that.

From those evaluations, we created a five-year business plan, laying out exactly what we were going to accomplish in terms of production of units, production of square footages, things like that, and also looked at our social mission, the other part of it.

We believe in rebuilding physical infrastructure and social infrastructure. Business plan covers all of that.

We then put together a succession plan and started recruiting younger folks to come into the organization to create a whole line of people who can take over down the road, expanded our service area, and became a little bit different as a CDC.

We were looked at as very avaricious. We were looked at as predatory because we were looking at ourselves from a different light.

We saw three years ago -- and it's very interesting that three years ago is coincidental with the last election we had -- we saw things getting ready to change. So we decided we were going to change. We saw weaknesses in other organizations in the CDC world, and we saw consolidation getting ready to happen.

So we put ourselves in the position to take advantage of that. Is that good? Maybe. Is it bad? Maybe. But that's how we decided to survive as an organization, looking at the future, predicting what was going to happen, and trying to take advantage of it.

I think you'll see across the country CDCs doing more and more of that. I think you'll also see in the industry at least in Kansas City, in the West they are forming funding collaboratives where folks are not just going after money by themselves, but forming collaboratives, going to corporations, banks. They're going to the government, foundations, with a strategy for their cities; then have those cities, those local foundations and other folks put money in a pot and then making the CDCs in that city responsible for their production, responsible for their financial health. All of those things become part of it.

So I think you'll see more of that happening. We view CDCs, CDFIs as part of the infrastructure that banks need to be able to invest in the communities that we deal with. I don't think that it can come into an urban community, what has been 30 years of disinvestment, and take a look at investments because they won't see them. They won't see any opportunity in those communities.

Well, folks like me, that's the only opportunity we see. You walk into a community, and you see devastation. You see vacant lots. Well, we see that as opportunities to build something to make a change.

So without the infrastructure, CDCs and CDFIs, the banks can't do their job. So I think it's the responsibility of banks to make sure that there's a strong infrastructure to help them make investments in those communities.

And we will take your money. One of our base philosophies, too, is that every time we see somebody who has a dollar, ask them for half of it.

(Laughter.)

MR. JAROLIMEK: I have Ron, Ruhi, and Connie.

CHAIRPERSON REITER: Well, Earl, based on the comments that have been made so far, I was curious whether -- well, I wanted to ask you really a crystal ball question, what the prognosis is of members of your community as to the long-term sustainability of nonprofits.

MR. JAROLIMEK: I'm going to invite some of the better informed community groups to respond to that. Connie?

MS. CHAMBERLIN: Well, I think that the issue -- and this is going to be sort of a round about way of getting to your question -- the issue cannot be that our goal is to sustain the nonprofit or the nonprofit community. Our goal has to be to create value, and in that environment, there are going to be some nonprofits who are lost. There are also going to be some nonprofits who become much leaner and meaner and more effective.

And ultimately, because we do believe that they create value, I think they are going to survive, but I think it's also going to take a lot more almost vertical collaboration and understanding of the role that the nonprofits play in making that lending possible.

And we talked a bit yesterday about the role of the GSEs and the secondary market generally, and they are just as good as anybody else at saying how important the nonprofits are, and then they do virtually nothing to support them. So we've talked about the possibility of somehow adding a fee on the secondary level that will go to support the essential work of making lending possible.

That's obviously going to be a long-term solution rather than a quick one, but I think, you know, in spite of the fact that we are talking about all of the problems that face this community, it's going to be a good thing when you get tougher, and I think we can all adjust our business models, but that's not going to solve the entire problem, and we have to recognize that's only part of the solution.

MR. JAROLIMEK: Ruhi and Dan.

MS. MAKER: I think the model we've adopted in Rochester, the Greater Rochester Community Reinvestment Coalition, and going back to the early '90s, we essentially went to the city, and we said that if you're going to do community development you need an infrastructure of not-for-profits that are, you know, able to produce housing, that are able to do housing counseling, that are able to do, you know, background support for small businesses or microenterprises, and we really pushed on that.

And that was the first coalition that I essentially convened and worked on, and once we had gotten that infrastructure, we then come in and our philosophy has always been that the money that a bank invests for CRA credit, whether it's an investment, whether it's a grant, is essentially money that we see as an investment that the bank puts into ultimately make profit on the customer who is served. I mean, that has always been our philosophy when we've gone to the banks, that this is not about charity. This is about funding an agency that already has some infrastructure support from a foundation or from, say, community development block grant money, where you fund the microenterprise.

I know we've talked a lot about housing, but, you know, we're very focused on jobs as well where you fund the microenterprise TA, you provide that technical assistance, eventually that customer is going to graduate to a small business lender and you're going to make money on him.

You provide the housing counseling. That customer is going to get a mortgage from you, home improvement loan from you, et cetera, et cetera.

So that has always been how we've tried to sell it, and we have no banks headquartered in Rochester anymore. We have a couple still in Buffalo, but we have found that we have, for example, a fund right now. It started off as a multimillion dollar fund which all the banks were in to buy foreclosed housing that's then turned around. It's owner occupied housing. It's for sale; it's rental, and it's turned around.

It was capitalized initially by a large bank. The second round of capitalization just occurred. There was competition. There was more money that the banks wanted to put in. It was a $16 million fund, and there was more than $16 million that, you know, seven, eight of the largest financial institutions wanted their money in there, and there was competition as to who was going to be the lead bank.

Whereas, you know, five years ago when we were first capitalizing and it was being done for the first time, we were saying, "This is good, you know." Agnes is smiling because Fleet is in there.

And I think that's really how I've always -- that's always been my philosophy. You know, you need to get CRA credits, but the point of getting CRA credits isn't just to get an outstanding. The point is to invest in that community, which is then going to grow and make you money.

And that's how I feel how we've got to keep selling CRA, and there is investment in there, and sometimes it's a long time before you get your money back, but you know, what Connie said, it's going to be lean and mean, but otherwise we're never going to be able to in this particular environment unless we have a huge turnaround in the economy, that's how we're going to have to continue to sell that this is an investment that you're ultimately going to make money on, and that has always been our philosophy and it continues to be our philosophy.

MR. JAROLIMEK: I have Dan, Buzz and Mark.

Dan.

MR. DIXON: Just a couple of quick comments. I am gratified that the banks have such a prominent role as the source of support. On the other hand, I think that we probably all agree that we're not the only source of support.

CRA exists as a law. We have obligations under that. I think most of the bankers in this group at least are committed to supporting communities in a variety of ways, not just because of CRA.

And, in fact, I know that there is a review process that has been underway for a while, reviewing the regulations under CRA, and there maybe -- you know, maybe it's appropriate to consider some different flavors.

Many of us are national companies, and there are lots of markets we serve, and it's not always directly connected to where we have retail branch offices, but of course, that's the way the CRA legislation was originally crafted.

And maybe that's no longer exactly appropriate. We have branches in nine states, but we lend in 40 states, and there are needs in all of those communities, and we obviously don't meet every need in every community, but we do good work in lots of communities, and it doesn't frankly all get credit under CRA.

And, again, we don't just do the good works because of CRA, but by the way, if we're going to have such a score card, then maybe it's appropriate to take a fresh look at that. In some cases you are in effect disincented from supporting some of the important communities just because of the way the act was crafted.

I'd also want to make the point that some of us are better at lending than we are at grant making, and that's an important element in all of this, and there are other entities in the marketplace that would have similar benefits of having community development and community reinvestment taking place. It isn't just the bankers who are going to be the source of the operating support, et cetera.

And I assume that, you know, you'll have opportunities to make some of these same presentations to a broad cross-section of industry.

MR. JAROLIMEK: I have Buzz and Mark.

Buzz.

MR. ROBERTS: A couple of points. One is I'm generally optimistic about the sustainability of certainly the CDC world where we operate. We have found that where CDCs are well managed, and that can be demonstrated requires benchmarks and transparency, and where you can show a direct path between the work of CDCs and community outcomes, and we're starting to do a better job in showing that direct path, that, in fact, people will recognize that and want to participate in it.

The trends, however, I would say from the banking industry and particularly among the big banks have been difficult over the last few years. When we see a merger, the banks hope that one plus one will equal more than two. In terms of community involvement and including money, but not just money, it's very seldom that one plus one equals more than two. We're lucky if we can get one plus one equaling one and a half, frankly.

And so there has been, I think, an overall diminishment from that perspective, and we also hear more and more from several big banks that CRA is less and less a driver of their community development activities. CRA is driving them more and more on the mortgage side, but less and less on the community development side.

It just doesn't show up very significantly on their CRA exams, and so they're looking at other reasons to do community development beyond CRA, and they have some.

So, I guess the bottom line is that there is some support out there, and I think the industry is changing and becoming, I think, more not just examining itself more closely, but also being willing to expose its own operations to greater external scrutiny, but as this movement expands, I don't think it's realistic to expect that philanthropy or charity from the corporate sector or the foundations is going to be sufficient to accommodate that expansion. It's going to have to come from government, and it's going to have to come on a partnership basis with government.

MR. JAROLIMEK: I have Mark, Charles, and Susan.

MR. PINSKY: Very briefly, Ron, I wanted to answer your question because I think it's the right question. Sorry, which is to say I'm also optimistic from the CDFI perspective about our sustainability. You know, I'm quite confident about that.

But actually, as I said earlier, I think it's going to happen through a sort of restructuring and a redesign of some of the systems and how the CDFI industry works.

But you know, we're playing around with ideas. We think that CDFI industry in the next two to three years can actually cut operating costs by 30-plus percent, maybe 40 percent, and we also think that if this sort of system redesign goes that within five to seven years we can increase our output, our financing by as much as an order of magnitude.

So, you know, I think it's going to take a significant change. Just to give you some idea, my organization just had a conference. We brought CDFI industry together last week, and our opening plenary was about just this, and we called it "Grow, Change or Die."

So we think it's time not to be subtle about these issues.

MR. JAROLIMEK: Charles.

MR. GASTON: Yeah, I wanted to speak back to Dan's point about banks being a large contributor to operating costs for CDCs, in particular. From my perspective, you know, if banks want to give us some money to help operate, we'll certainly accept it, but I'm much more concerned about getting money for the loans, you know.

I've never done a project without having a bank loan involved in it. Some of the LTVs are a little bit low, but they're always involved. So for me, you know, the banking community is a partner in every deal I do. So I'm just looking for higher LTVs, lower debt coverage ratios, you know, those kind of things to make my deals work.

Normally when we do deals, a bank will have maybe 40 percent or 50 percent of the money involved in a deal. If I can get that up to 60, or 70, that helps a whole lot.

The risk factors, of course, are greater in our communities, but we accept that, and again, you're our partners in terms of the deal making. If you've got some operating cash, we'll take that, too.

MR. JAROLIMEK: Susan and then Elizabeth.

MS. BREDEHOFT: My remarks are going to be a little bit more specific. I'm a banker, but I'm treasurer of a CDFI and a well established CDFI. I can tell you what we need. We need investment advisory services.

We thought we had a very good investment policy and philosophy and that we invested in triple A bonds, and unfortunately we invested in WorldCom, and you know, we suffered a significant loss on that particular investment.

So now what we've done, we've gone to the complete opposite. Our investment policy is very conservative, and the return on those investments are very low. So we really could use help with that.

We did put out an RFP to some of the, you know, investment advisors in our area, but we found they really don't understand our business, and that's a key. So maybe establishing an investment advisory that could help CDIs and nonprofits would be a really good thing.

The other thing we could use help with is asset and liability management. What is our pricing? Are we pricing correctly? We think we are. Don't know for sure.

Long term investments, we decided this past year since interest rates were so low we would go out for long-term investments from our bank investors figuring that that would be a really great thing to do.

But in meeting with our examiners, the way they look at the investment test is they want to see continuing additional investments. So a long-term investment by a bank doesn't necessarily get the best CRA credit for the bank. So investors want to see renewable investments.

What else do bankers want? We want a return, not necessarily a dollar return on the investment, but we want to be repaid for our investment, and we want CRA credit in the best way we can get it to enhance our CRA ratings.

So anyway, that's my piece of the pie.

MR. JAROLIMEK: I have Elizabeth, Clint, and Connie.

Elizabeth.

MS. RENUART: I just wanted to key off on some observations that Connie made earlier way back probably half an hour ago that I thought actually for me anyway extended the discussion beyond the narrower focus of CDCs and CDFI, of which I don't know that much about but appreciate the work they're doing.

But the part that she did talk about that I do know something about are housing counselors and the role that they play in the community in terms of getting these products available to people, getting people ready for the particular lending products that might be available, and then keeping them in the homes once they are in the home.

And I wanted to very much support the idea of additional funding for housing counselors, but I have a cautionary note about that, and that is that housing counselors is part of a larger group of nonprofits called credit counselors, and that credit counseling segment of the community, some of those nonprofit credit counselors are really for-profits operating under the protection of a nonprofit basis because a nonprofit status allows them to be exempt from various state laws that might regulate what they do.

And our organization, along with Consumer Federation of America, put our recent report where we studied the credit counseling industry as a whole and found that there were from our perspective anyway some abuses in obtaining and maintaining this nonprofit status, given the huge salaries that the companies drew down for some of their major corporations.

Recently the IRS has come out with saying that they're going to be investigating the credit counseling industry more carefully. All of that is really to say that there are wonderful housing counselors. There are wonderful credit counselors, but if money is ever made available to fund these entities more fully, and the good ones definitely ought to be funded more fully because they provide such a valuable service in both, again, getting people in and maintaining their housing. We have to look carefully as to who should get that funding and so that the nonprofit label shouldn't necessarily be determinative of who gets the funding when that happens.

MR. JAROLIMEK: Clint, Connie, and Hubert.

MR. WALKER: Yeah, I'd just kind of like to add a little bit to what Buzz and Connie said from the banking side, but the geographic support that, you know, banks give, and we're very interested in CRA and we do that, and we're very interested in community development.

Now, we are national. We're small. We're credit cards. We lend nationally, but from a community development point of view, we're really interested in the area where we are. We want to make the community where we're located, and we located our bank in a distressed area on the waterfront in Delaware. We do a lot of community work, but we're doing it to make it a better place for our employees to work, live, and play.

That's where we are, and where we're not, like for your area, it's going to create a problem. So I do think that you're right. You have to look elsewhere. That's what the bank's interest is going to be once you get beyond CRA where they are physically, and they'll do a good job there.

But where they're not, it's going to create problems for people. That's why I think you've got to look elsewhere for support.

MR. JAROLIMEK: Connie and then Hubert.

MS. CHAMBERLIN: Well, something that Susan said made me think of another issue. The CDCs and other nonprofits working in the communities generally receive some form of local funding, sometimes state funding, and this is part of a very political process.

These entities do not necessarily have the business experience, the ability to do the kinds of things that Chuck described in developing a new business model, and normally the distribution of funds in the middle of the political process is guided in great part by those people in the local governments who are essentially planners.

They are not business people. They know what they want to accomplish, and they have some idea of holding entities accountable, but in the middle of a political process that can be very, very difficult.

And so you have a real lack of capacity building opportunities. In those communities in which LISK is active, then LISK is doing precisely that kind of thing, trying to develop capacity within the CDC community in particular.

But there is a real gap there in oversight, and I don't mean that in a technical, regulatory term, but from the standpoint of how do we insure that the nonprofits in the community become as strong as they can, and how do we let the others die?

And there's nobody in the whole funding structure that has the capacity to look at that.

MR. JAROLIMEK: Hubert.

MR. VAN TOL: Several years ago there was a serious conversation, I think, between community groups and the banking industry about making the outstanding ratings actually mean something, and that discussion foundered on the issue of banks wanting a safe harbor; if they received an outstanding CRA rating, to not be subject to any challenges.

I think for community groups that was a nonstarter because from the community group perspective, there was not enough confidence that an outstanding CRA rating really meant as much as it should, but I think it's time to reopen that discussion. I think we on the community side ought to be willing to reopen that discussion because of these reasons.

Buzz mentioned earlier about, you know, banks wondering what they're gaining from their community development lending, their long-term investments in communities. I'm not sure, you know, what the answer to that question is, but I think more and more from both of our sides we're seeing that an outstanding rating, while it's nice probably from the bank perspective for publicity purpose, it creates not that much value.

From the community side, we wonder whether there's really that much distinction between, you know, some of the outstanding ratings and some of the satisfactory ratings, and from my perspective in rural areas, I think that's particularly true for some of, not the major national banks, but the smaller banks in the billion to $10 billion, who are sort of the regional banks in rural areas.

You know, finding ways to provide them with more incentive to do the investments, the basic investments, would be an important step that we could take. I think that's going to be a difficult conversation. I'm not sure that in the end it would be fruitful if, once again, the issue becomes safe harbor.

But I think we should try.

MR. JAROLIMEK: You know, if I could turn the discussion a little bit more into a more specific topic, which would be some of the members could expound upon what the fed's role might be in some of the solutions we've talked about already today, if anyone has anything they could identify from our conversation yesterday.

Connie?

MS. CHAMBERLIN: Well, I think one of the roles that the fed could play would be essentially to convene discussions at a very high level among those government and other entities that are concerned with the issue and have an interest in insuring that lending continues to occur in these communities, and that would include HUD. It would include the GSEs. It should certainly include some of the lenders because this is all addressed in bits and pieces, and I don't think anyone has a very clear understanding of how the whole system works, and it's certainly not an effectively designed system.

HUD provides funding for housing counseling agencies, but they really, in spite of the theory, do not provide much oversight, and although I don't know that they provide funding to the entities that Elizabeth was talking about, I certainly would not use their system as a model for how you determine what the most effective way or funding these entities might be.

But I think that that kind of discussion and if the Fed initiates it, then people are going to listen. People are going to pay attention, and the whole concept of the fact that these services really do add value to the process is going to be underlined.

MR. JAROLIMEK: Robin.

MS. COFFEY: Yeah, I think one of the things we also talked about at the local district level, there's been such a change in personnel both at banks and with some of the new emerging CDCs and CDFIs that just a conversation at the district level with community affairs about what it is the banks are looking for, what it is community development corporations are looking for, just kind of basic conversation, the kinds of things we probably did 10 or 15 years ago, but we have tended to forget that there are now new players in a lot of our markets who haven't been exposed to the kind of conversations that we've probably historically had. So that was another idea we put out there.

MR. JAROLIMEK: Anyone else have any additional comments? Buzz.

MR. ROBERTS: Well, I do think the CRA process does come into play here and particularly with regard to issues like performance contacts and community development, but secondarily I want to echo what Robin said and make sure that those local conversations where really the Fed CIOs are so well respected and are so well integrated into the local institutional networks not just among banks, but local governments, state governments, the foundation world, the whole ecosystem; to have those conversations move forward and to focus really on many of the issues we've discussed today, from operating efficiency to transparency, to what the realistic roles of different sectors can be in sustaining and expanding the system.

MR. JAROLIMEK: Very good. Thanks, all, for your very good input. That was a great discussion, I believe, and, Ron, with that I think I'll turn it back to you.

CHAIRPERSON REITER: Okay. Thank you very much, Earl, and thanks to your committee.

I'd like to turn the discussion over now to Pat McCoy for discussion of convenience checks.

MS. McCOY: Good. Thank you, Ron.

Yesterday in the Consumer Credit Committee, we discussed the legal treatment of convenience checks under the Truth and Lending Act, and it turns out it was a surprise to many of us on the committee that there's actually an anomaly in the legal treatment of convenience checks. As we know, credit cards and convenience checks are two different devices for accessing credit lines and credit cards accounts. But the legal rules governing the two are not always the same.

And it turns out that there are four principal areas where the legal rules differ, three of which are substantive in nature. The first substantive one is that the ability to raise claims and defenses sometimes are difference, and the particular situation is if a cardholder uses a credit card to buy goods or services and later says, "I got what I ordered, but it's not what I expect," if they used a credit card, they can raise that claim or defense against the card issuer, but that's not true if they paid with a convenience check. And right now many of the disclosures on credit card statements don't make that clear.

The second substantive difference is the treatment for unauthorized use of a credit card versus a convenience check. If a credit card has unauthorized use, the total liability is capped at $50, and account holders have no liability for unauthorized charges made on a credit card after they notify the card issuer that the card is lost.

For convenience checks, there's a completely different set of rules. Under the Uniform Commercial Code, consumers have no liability if the check is forged unless they were somehow negligent in losing control of the check, and in that case they bear the entire loss, or if both the bank and the customer are negligence, then the loss will be shared between them.

And, once again, this difference in the rules is generally not disclosed on credit card statements. Particularly how it's different for convenience checks is almost never disclosed.

Finally, for claims asserted orally or in writing after 60 days where a credit card is used, the creditor must investigate, but that's not true where a convenience check was used.

The third substantive difference is that credit cards generally may be issued only upon request or on a substitute basis, but that's not true for convenience checks. They arrive on an unsolicited basis, and there's really no way to turn off the flow of the convenience checks coming to your door.

The last area of different treatment is disclosure, and there appears to be among consumers some confusion about the APRs and fees that apply to convenience checks. Generally card issuers will apply the cash advance rate to convenience checks, and sometimes the marketing literature will say, "Use these checks as you would use your card to obtain cash advances," but that's a little oblique in letting the consumer know that the cash advance rate applies.

And if the APR for cash advances is, in fact, going to be used, the convenience check simply can refer you back to earlier disclosures without telling you what that precise number is. That seems to give rise to consumers' confusion.

So then the question is: well, what drives these differences? And essentially it turns on the definition of the term "credit card." In the statute itself, the Truth in Lending Act, a credit card, among other things, is defined as a credit device existing for the purpose of obtaining money, et cetera, on credit.

In the rules interpreting the statute, the Board has agreed that convenience checks are a credit device or are a device, but nevertheless has defined them not to be credit cards because a credit card under Board definitions is a device that may be used from time to time to obtain credit, in other words, repeatedly. And the Board's view to date has been that a convenience check is only used once.

But it's within the Board's discretion to define convenience checks as credit cards and so chooses, and it could do so for some purposes and not for others.

So with that, if I could turn the discussion over first to Ron, and then we'll open it to the entire committee.

CHAIRPERSON REITER: Thanks, Pat.

I think that your summary of the situation of the law was very comprehensive and excellent. We have a very strange situation. People have credit cards. They receive almost sometimes relentlessly convenience checks. Probably convenience checks have been a great subsidy for the home paper shredder industry, but in any event, we do receive the convenience checks and are encouraged to use them and are encouraged to use them for any sorts of use, including buying gifts, buying items.

And you have a very strange situation that if you walk into a store and you buy a television set with your credit card, you have a whole series of rights that attach to that transaction. If, for example, the television set doesn't work and you can't resolve the matter with the merchant, you're able to contact your credit card and assert a defense of the payment based upon breach of warranty or the failure of the item to work.

If, however, you have a convenience check drawn on the exact same account to which the credit card is associated and you pay with that check, you do not have the right to assert the claim defense. It's an anomaly that doesn't seem to make much sense at all.

Under the Truth in Lending Act itself, where Congress established the right to assert a claim defense, it limited this to cardholders, but as Pat pointed out, it defined a credit card as a device that's used to, in effect, access the line of credit.

It's really an anomaly created unfortunately by regs.' gloss to the definition of credit cards. It's not only a device that's used to act as credit, but it's a device that has to be used in a repeated fashion.

And since the Board has concluded that a check isn't obviously -- it's used once and not in a repeated fashion -- a check is not, quote, unquote, a credit card, and as a result, by using the convenience check, you don't have the kinds of rights which are associated with the actual use of the credit card.

Interestingly enough, however, the Board has opined that making a telephone purchase or using the Internet to make a purchase does qualify for credit card type treatment. I don't know whether the notion is that your computer can be used more than once or your telephone can be used more than once, but at least there is a notion --

(Laughter.)

CHAIRPERSON REITER: -- there is a notion that the rights that adhere in the use of a credit card should also apply to purchases in the electronic age.

But here we have this sort of strange situation with the checks, and it, of course, 20 years ago was not as much of an issue because convenience checks were not distributed to the same extent that they are now, but I probably receive a set of convenience checks almost on a weekly basis from somebody or another, and it is rather strange that the different rules apply.

So what I would suggest is that the Board reexamine this issue so that the same rules apply in defining the legal rights and responsibilities of a consumer and a bank with respect to an open end credit card type of transaction.

The second issue that Pat pointed out really relates to a disclosure of APR. When the convenience checks are issued to you often there is a special bonus that's offered to you when you use the convenience checks, and sometimes, for example, if you use a convenience check to transfer a balance from one credit card to another, that is, by paying off another credit card and then, in effect, transferring the balance to the credit card associated with the convenience check, you my get a special introductory rate, a lower APR, a waiver of cash transaction charges, et cetera.

But if you use the same check to buy the television set, you don't get that advantage, and cash transaction fees, cash advance fees apply, as well as perhaps even a higher APR for the use of the checks.

And all of this is rather mysterious. It may be disclosed; it tends to be disclosed in the type on the back somewhere, very easy for people to miss that, and it's also difficult to really know what's going on because it may change from time to time. One week you get convenience checks from the credit card and there's a special term offer, and then the next two weeks later you may get them and they're different terms.

So that having a more prominent disclosure with the convenience checks as to what the particular rules are or the sale price only good until next Tuesday, whatever those rules are would be made more clear to the user so that they have a much better idea what the nature of the transaction is.

Thank you, Pat.

MS. McCOY: Yes. Thank you, Ron.

Oscar and then Clint.

MR. MARQUIS: Thank you.

I think we had a very interesting discussion about this yesterday, and there wasn't a lot of disagreement about the fundamental position a consumer should be in in using a credit card to access -- I mean using a check to access a credit account or a credit card account. But I think there are problems.

Pat started by talking about consumer confusion with the convenience checks. I think it would be extremely confusing and anomalous to call a check a credit card. I think that would be confusing to most consumers.

Court cases tend to hold that checks are not instruments of credit, but are instruments of cash, are closer to cash, and in fact, a consumer using a personal check to make a purchase is in the same position as if they had used cash and they don't have the claims and defenses that they would have under a credit card.

But I think on the whole we don't think -- in our discussion yesterday I think there was fairly much agreement that it makes sense to have consumers have the same claims and defenses for using a convenience check as they would for using the credit card.

But calling the check a credit card brings with it a lot of the regulations or obligations under regulations that wouldn't make sense. One in particular which permits the sending of convenience checks without requests wouldn't be possible if the convenience check were considered a credit card. And if convenience checks can't be sent without a consumer requesting it, there really wouldn't be any convenience checks, which may save a lot of paper, but convenience checks work. Consumers do use them. Many like them. Some may be confused by getting them, but you can toss them.

The fact that many consumers use them, I think, mitigates against doing away with the product or the service.

MS. McCOY: Oscar, thank you.

I think one of the comments that came out yesterday is that many consumers feel that when they access the account, however they do it, that their legal rights are the same, and perhaps one say to accommodate your concern is to define convenience checks as a credit card only for certain purposes, only for purposes, let's say, of claims and defense.

Clint.

MR. WALKER: Good. What I'll say probably follows on what both of you and Oscar just said.

The one thing I would start with first though is there is one difference with checks in that checks are processed through a different system than the card or Internet transactions or transactions over the phone. I'm not saying that that's a reason to treat them differently.

MS. McCOY: Can you speak into your mic a little?

MR. WALKER: Oh, I'm sorry.

You know, I totally agree, and you know, my bank, you know, we treat them the same for claims and unauthorized use purposes. There's no reason to, but it is processed through a different, you know, physical system, and that is a difference.

That states, the one thing I would like to say that's really important to us as a credit card issuer is the point that Oscar made, that we have the right to send convenience checks to our existing customers. They are a convenience. Checks can be used in certain places cards can't be used, and you know, that's why they're called a convenience check.

We also have the ability to offer special rates. Ron mentioned that. But it is a way to, one, encourage use and, two, to give the consumer some benefit. So kind of the process that you were talking about, Pat. It's not something that's, you know, inimical to us. It's very important to us that we have the ability to, you know, send these checks to our existing customers. We find our customers like them.

One of the reasons people always worry about this is fraud, and you know, initially the concern about sending out unsolicited credit cards was a fraud issue that's less an issue now when card issuers are requiring people to call a 1-800 number.

But even with that, the amount of fraud involving convenience checks is substantially lower. I mean multiples and multiples lower than the amount of fraud with regard to your use of credit card. It's very, very minimal.

So there really isn't, I think, good reason to prohibit the sending of checks on an unsolicited basis.

And then finally, on disclosures we always believe, you know, and in fact, when we send a check with one of our promotional rates, Ron, we make sure if there is -- and sometimes that's promotions that there isn't a fee -- but if the fee applies or if the fee doesn't apply, we'll tell them. We'll tell them what the rate is.

I mean, I think that's, you know, elemental stuff and, you know, we try to do that.

MS. McCOY: Ken.

MR. BORDELON: During that discussion yesterday in our committee, I think it is obvious why the Board probably separated the two. Just to echo what Clint says, the check does process through a different operational technique. For one thing, most of these checks are not authorized in that most cash advanced are done over the counter with a card or authorized and the balance is automatically held by the credit card company.

So it's very common for these checks to be returned NSF and for large amounts, and the way around that from the industry, I think what we'd like to see is a simple technique that there's an authorization technique on the check. There's an 800 number to call, and it can be, in fact, verified as a cash advance just like anything else.

And, again, I think there was general consensus on the disclosures. I do see an issue though in billing errors and claims and defenses because a lot of these checks, I think, were issued for the purpose of being able to be used where credit cards are not accepted. So that if the merchant is not accepting Visa or MasterCard credit cards, but they are accepting the check, we may have an issue there with claims and defenses and billing errors there. And that's where I think really it's going to get kind of sticky, is to try to separate the two.

MS. McCOY: And thank you.

Elizabeth.

MS. RENUART: Just to help answer or at least perhaps give answers to the three gentlemen over there in the suits who came up with --

(Laughter.)

MR. BORDELON: Blazer.

(Laughter.)

MS. RENUART: Those credit unions, they're so radical right now.

(Laughter.)

MS. RENUART: As far as the unsolicited issue, I go further than Pat's response. Pat's response to the issue that the industry would be like to be able to send the convenience checks out on a unsolicited basis, I don't have any objection to that particular request, except I would suggest a tighter rule than what Pat suggested, and that is that the credit card or the convenience check can be defined as a credit card for all purposes, except that one particular rule, which you said, except for certain things.

If we start saying, "Okay. Except for this and except for that," we're in the situation we're in now, which is that convenience checks fall under very few provisions of the Regulation Z and the Truth in Lending Act.

So if we're going to have an exception for unsolicited convenience checks, that's fine, but just let's limit it to that one. So that, yeah, there are claims and defenses and other problems that people have identified are covered for convenience checks.

The fact that they are processed through different systems and they have different rates of fraud or issues like that is solely within the discretion of the credit card issuers themselves because they're the ones who issue the convenience checks. They don't have to send them out. They don't have to offer access to the card account through that particular device.

So you know, Ken's suggestion to tighten that up by having an authorization number is an excellent one, but that doesn't have Regulation Z implications. That's just something the industry ought to do to protect itself, and that makes perfect sense.

As far as merchants not being in the particular Visa system and, therefore, how does the claim and defense work, again, it's the banks themselves that offer these checks. So it seems to me it shouldn't be the consumers' problem that the checks are issued in a way where you may have some difficulty getting back to the merchant to make a claim good if the bank is left holding the bag because, again, it's your device. It's your methodology that you're offering the consumer to access their account.

So that should not, in my view create a distinction under Reg. Z between convenience checks and credit cards themselves.

MS. McCOY: Benjamin.

MR. ROBINSON: I think one of the interesting things for me is that banking products and services have evolved significantly over time, and unfortunately rules and regulations haven't always kept up with the changes in technology.

For example, credit card accounts are used for overdraft protection. That's something that we didn't imagine a long time ago.

One of the primary purposes for convenience checks, and I think we haven't really touched upon, is that it is an opportunity for a consumer to transfer to a more attractive rate, and that does happen, and I think that happens more often than we would like to acknowledge in this forum, but I'd like to encourage us to also look at the positive things have with convenience checks and other items.

MS. McCOY: And then Ron.

CHAIRPERSON REITER: Well, just I agree with Benjamin's comments, and I don't think anything that we've been talking about here would -- no one is suggesting that convenience checks be abolished, and I don't think that any of the rules that we're talking about applying here would really inhibit the use of convenience checks to transfer balances from one account to another.

We're really looking at some more fundamental questions of claims and defenses. One point, I guess, that hadn't been made is that there's also a difference in the right of set-off. Under sort of normal banking law, going back hundreds of years, bankers had a lien on whatever deposits they had so that if there were a dispute, if there were issues, they'd get to exercise its lien and take other assets of the customer.

There's a specific prohibition in the Truth in Lending Act and in Reg. Z for banks to exercise that and banker's liens and exercise, in fact, a set-off against checking accounts and savings deposits and other things that the consumer might have as a result of the dispute regarding an unpaid credit card balance. That rule does not apply to convenience checks.

So you can certainly have a situation going back to the TV set that doesn't work. If you pay with your credit card and you can't resolve the matter with the merchant, you ultimately can assert the defense to payment with your credit card.

In any event, the bank is not able to exercise its conventional banker's lien to take money out of your checking account to satisfy that disputed amount.

On the other hand, if you pay with a convenience check, not only can you not assert a claim of defense, but if you say to the bank, "What the heck. I'm not paying you anyway because this darn TV set doesn't work," the bank can seize your checking account or your certificates of deposit or whatever else the bank might have.

So there are a whole series of legal rights that exist for cardholders, and it really doesn't matter for this specific purpose how the payment is processed.

I absolutely agree with the comments made by Clint and by Ken that the checks are processed through a different system. They clear differently. They get posted at different times and all of that, but that doesn't affect the right that should exist as between the customer and the bank with regard to the draw on the open-end account.

And various mechanisms, as Elizabeth pointed out, can be worked out to protect the bank with regard to the use of the convenience check, including writing on it that it is a convenience check and you're subject to claims. Something could happen so that you'd have an ability to charge back in the event you haven't -- either you paid the item or you returned the item because of the claim and defense asserted.

MS. McCOY: Thank you, Ron.

Anthony.

MR. ABBATE: Yes. I'm not an attorney. However, it seems to me that there are two separate claims and defenses here that conflict with each other. The check is being negotiated and subjected to the rules of the Uniform Commercial Code. So people that issue checks, draw checks, pay checks, operate under the Uniform Commercial Code, and there are rights and remedies that exist under that law.

And in terms of what we're talking here about the credit cards, we're talking about another set of claims and defenses. So it seems to me that are you going to mix and match; are you going to try to amend the Uniform Commercial Code, which is a national initiative, state by state to cover convenience checks or is this just simply a matter of disclosure?

I think there has to be adequate disclosure to begin with to let people know what the true costs are referring them back to their original agreement, and I do agree that under a credit card that you are entitled to rights and remedies, but somehow we have a conflict here, and which does the consumer take as his defense, that under the Uniform Commercial Code or does he take his defense under the regulation, Truth in Lending or whatever other consumer law applies? And I think you have to square with that before you go to the next step.

MS. McCOY: If I may respond to that, it's a clash of the issuer's own making. If these convenience checks have been issued specifically to draw on credit card accounts, and that is the understanding of many consumers, it's certainly possible by virtue of the definition of convenience checks as credit cards to make them subject to the same claims and defenses as credit cards, and that's within the Board's discretion.

And to me it's immanently fair in accords with the expectations that are created by issuing convenience checks that are attached to credit card accounts.

Other comments? Yes, first Larry and then Dan.

MR. HAWKINS: Well, first of all, in fear of sounding like a suit --

(Laughter.)

MR. HAWKINS: -- I want to say that I believe it is more a matter of disclosure. The convenience check is just a matter of access to credit, and I think, Pat, I'm not certain that I would agree that the concern for many consumers because I believe many consumers don't care, but I think it is a matter of disclosure.

I don't think that a lot of other stuff needs to be changed; that probably the disclosure needs to be changed because it is. It's only a matter of accessing credit. Just like they can go in and get a cash advance or they could make a phone call to access credit, that's all a convenience check is. It's a matter of accessing.

So, therefore, maybe the disclosure needs to be changed to reflect that they're the same defenses, same remedies that you would no matter how you access credit on your account because that's all it is.

MS. McCOY: Dan.

MR. DIXON: I have more of a question than a comment. Following up on Anthony's comment about Uniform Commercial Code, I was thinking we talked about the relationship between the customer, the cardholder, if you will, and the credit card issuer, but the other party in this case is the merchant or whoever is the payee on the check, and disclosures from the credit card company to the customer may help clarify what their relative standing is.

But from the standpoint of the merchant all they know is they got a check, and they have a certain expectation. So I would be curious as to what the implications might be for changing, you know, the claims and defenses.

For example, if a merchant has accepted a check and has an expectation that they've delivered some product or service and they have a relationship with the buyer and now suddenly a dispute arises and, you know, Visa steps in or Citibank steps into the middle of this dispute, I'm not sure that merchants are going to welcome that intervention. I mean, it's a question.

MS. McCOY: Ron.

CHAIRPERSON REITER: Well, I guess two points. First of all, just sort of in response to Dan's point, I mean, merchants when they take checks with all kinds of risks, including the fact that a check may be drawn on an account that's been closed, that it's an NSF check, and all of that.

So there's a risk inherent in taking a check, and I think certainly if additional disclosure is necessary because these convenience checks are a special animal, certainly there could be something written on the check. This is a convenience check or you're taking it subject to consumer claims or whatever, but so that there could be actually a disclosure that's included on the check if that were found to be necessary.

I think inherently a merchant who is taking a check is in a very different position than a merchant who accepts a credit card and calls in or through the automated system gets an authorization for the card and knows that he's got a payment there. So I think that's part of the risk that the payee of the check takes on.

But I'd like to also respond to Anthony's comment. The rules really don't conflict at all. There's something very different that's going on. In a typical checking relation where you deposit a check and the relation of the drawer of the check and the bank is governed by the commercial code, there's no question about that, but it's usually accessing a demand deposit account.

Here there's not a demand deposit account that's being accessed. It's a credit card, and it's an open-end account that has its own unique set of rules, and it's perfectly compatible to deposit the check, have it paid by the midnight deadline, do all of the commercial code requirements, and at the same time have this additional rule engrafted on the relationship between the bank and the customer, and that is that since it's a draw on credit, that the rules that apply to credit draws apply to that transaction.

So I don't find that there is a conflict. I just think that it's an additional requirement just because of the nature of the transactions.

MS. McCOY: Oscar.

CHAIRPERSON REITER: No different really than if there had been really a credit card.

MR. ABBATE: Then let's take another step further. How are you going to treat checks that are issued to customers of home equity lines of credit that they draw against their line of credit? I mean, it's the same thing, isn't it? Isn't it the same thing?

CHAIRPERSON REITER: Well, there's --

MR. ABBATE: It goes to a merchant, and instead of taking an advance against his line of credit, he uses a check instead to access his line of credit. How is that going to work?

CHAIRPERSON REITER: Well, the rules are different for credit card accounts than they are for secured lines of credit.

MS. McCOY: Oscar.

MR. MARQUIS: Let me just make two points. Ron, you're right. The merchant has different expectations and risks when they take a check, but after the check clears, they're paid and they're out of it. And I think under Truth and Lending their claims and defenses may take effect afterwards, and the merchant faces the risk of having the payment reversed or something? I don't understand how that would work.

But these are added complexities. I think we're basically in agreement that claims and defenses to a certain extent should apply if it can be made to work.

But my second point on notices, notices are wonderful. We keep talking about notices, but let's be realistic about notices. They don't communicate a lot of information to consumers who don't read them, and most don't.

What notices do is provide the financial institution a defense. We provided the notice. The consumer may not have read it, may not have understood it. If you have a notice saying this check is a credit card, they may stop reading right there and figure that they won't understand the rest of it because it doesn't make any sense.

(Laughter.)

MR. MARQUIS: But it's a defense for the merchant. So providing for notices is wonderful, and I'm not sure that's what you want to do.

MS. McCOY: Well, something tells me that the disclosure would not be this check is a credit card. It would be a little more substantive in nature.

(Laughter.)

MS. McCOY: Let's see. I have Larry.

MR. HAWKINS: And I want to just comment about the lines of credits. I see that as being quite different. I mean, I don't know that banks are going to set up separate accounts for folks who have these open-ended lines of credit. It's probably going to be more of a matter of funds flowing into an existing account. Then you're just in the same arena.

I mean, if somebody goes and gives somebody a check, they can call to try to confirm it or they run it, but it's going to be totally different. It's going to be totally different, I think, from the convenience check argument.

MS. McCOY: Other comments?

MR. ABBATE: I was just trying to stimulate a little discussion.

(Laughter.)

MS. McCOY: Anthony, you have succeeded splendidly.

Yes, Diane.

MS. THOMPSON: I just wanted to say that about the claims and defenses, the merchant is subject to the consumer's claims and defenses whether or not we change the rules for convenience checks. The merchant is always subject to those claims and defenses.

What this changes is whether or not the consumer can assert those claims against the person they have to pay, which is the credit card company. That's the difference. It doesn't change the merchant's potential liability.

MS. McCOY: Any other comments?

(No response.)

MS. McCOY: If not, if I could quote Oscar, it looks as if claims and defenses could be made the same, the ability to raise it against the credit card issuer for convenience checks and credit cards, and there is at least a sense among many on the Council that if it be worth pursuing, that as well as looking at the issue of the disclosures for fees and APRs.

Thank you very much.

CHAIRPERSON REITER: Can I just add one thing to the discussion?

MS. McCOY: Yes.

CHAIRPERSON REITER: I think the agreement might even be broader than that. Where I sense there was some issue was with regard to the issuance of the convenience checks and whether the issuance should be treated as an unsolicited issuance and, therefore, prohibited or whether convenience checks should be able to come as the morning sun.

But with regard to some of the other issues, claims and defense is certainly, but there's the issue of setoff. There's the issue of billing error resolution, whether also some different roles; that all of those kinds of things should be treated in a similar fashion regardless of the method used to access the credit account.

MS. McCOY: Thank you.

CHAIRPERSON REITER: Thank you very much, Pat.

Well, I think we're ready for a break. Let us reconvene at 11 o'clock to start a discussion on payroll cards.

(Whereupon, the foregoing matter went off the record at 10:37 a.m. and went back on the record at 11:02 a.m.)

CHAIRPERSON REITER: One comment to Council members. We'd appreciate if you'd speak more into the microphone. It has been difficult for some speakers to be heard in the audience and even to be picked up on the transcript. So we want to make sure that you are heard.

I'd like to turn the meeting over to Oscar for a discussion of payroll cards.

MR. MARQUIS: Thank you very much, Ron.

The next topic is payroll cards and their coverage under the regulations and the law. Payroll cards are mediums that employees have started using to pay salaries, focusing on the unbanked. Employers prefer direct deposits. They prefer not to issue checks for employment or for employees because there's a considerable cost involved. There are reports that issued checks have cost or reissued checks for lost checks or whatever have cost companies up to $40 million a year.

So they encourage direct deposits, but how do you handle consumers who don't have banking relationships? For those, the payroll card has been developed, and the latest studies of 2002 indicate that 10 percent of the unbanked employees use payroll cards, and that comes to about a million households. It's expected that that will increase to about 25 percent of the unbanked by 2006.

So how are these payroll cards used? The employees who get them can withdraw cash at ATMs or other banks that utilize various networks. The full cash value can be withdrawn from the bank that issued the card. They can request cash when they use the card for making purchases and get cash for the difference. They can get convenience checks.

(Laughter.)

MR. MARQUIS: Which are, of course, mailed unsolicited.

(Laughter.)

MR. MARQUIS: Or they can request that the full balance be transferred to a credit card account or to some other kind of account.

So the questions we were asked to address in the committee was: should payroll cards be covered by the Electronic Funds Transfer Act and Regulation E or should Reg. E be modified in some way to accommodate payroll cards and exclude other types of cards that hold value of cash or value cards. What do we call them?

CHAIRPERSON REITER: Stored value card.

MR. MARQUIS: Stored value card, which leads us to what would be the obligations if payroll cards did come under Regulation E, and to tell us about that, who was it?

MS. BREDEHOFT: Me.

MR. MARQUIS: Susan. You're going to tell us about Regulation E.

MS. BREDEHOFT: I'm going to summarize Regulation E. So here goes.

(Laughter.)

MS. BREDEHOFT: Can you hear me?

PARTICIPANT: I can.

MS. BREDEHOFT: You can? Okay, great.

Okay. Regulation E, the Electronic Funds Transfer Act establishes rights, liabilities and responsibilities of consumers who use electronic funds transfer services and of the financial institutions that offer these services.

Covered transactions include ATM transactions, point of sale, such as when you use your card at a grocery store to pay your grocery bill, direct deposits, such as payroll deposits or dividend income, and preauthorized transfers, and these are prearranged monthly debits to your accounts that you may use to pay your utility bills or your mortgage.

The benefits that Reg. E offers to consumers include the following: financial institutions are required to give disclosures, and these disclosures include such information as the types of transactions that are covered, frequency of transactions, fees that may be incurred in a transaction, contact information at the bank if you have a problem.

It also covers liability, the customer's liability for unauthorized transfers, and error resolution rights under the regulation.

The regulation also requires that receipts be generated for each transaction, that periodic statements be issued by the financial institution.

It also prescribes liability. The liability can be limited to $50 or it could be unlimited liability to the customer, depending on when the customer reports the loss or theft of the card to the financial institution.

Under the error resolution rights, the regulation establishes time periods. Generally an error must be resolved within ten days or the financial institution must provide provisional credit to the customer if it can't resolve the issue. So we must give the money back to the customer.

That money can be recovered by the financial institution if we find that it wasn't really an error.

The items that we discussed in relation to Regulation E are do employees meet the definition of customer. The employees who receive the payroll cards, do they meet the definition of customer? And do the underlying payroll accounts meet the definition of account under Regulation E?

And this, of course, leads to the primary issue. Are payroll cards subject to or should they be subject to Regulation E?

MR. MARQUIS: And before we get to that specifically, Ron, are there any problems with payroll cards?

CHAIRPERSON REITER: I'm glad you asked, Oscar.

(Laughter.)

CHAIRPERSON REITER: Well, let me begin with --

(Laughter.)

MR. MARQUIS: They sound wonderful.

CHAIRPERSON REITER: We recently had a situation in California in which a check casher partnered with a bank to form a third company that was going to act as a servicing agent for the handling of these payroll cards. The company marketed services, got a number of employers to sign up. Most of the employees were either transitory type employees or workers at lower levels of employment, farm workers, restaurant workers, hotel workers, et cetera.

And then one day in July, the servicing company issued a press release thanking everybody for utilizing its services and indicating that the next day it was going out of business and that the payroll cards would not be honored anywhere.

There then ensued sort of a huge problem of trying to track where the money was and to try to figure out a way in which the employees who had their wages already earned on this card, how they could get access to the funds which luckily were available at the bank, but the mechanism of trying to inform people because the card they had only mentioned the servicing company, to try to inform them of where the bank was. The bank was located sometimes hundreds of miles from where the employees resided. Many of the employees were monolingual Spanish speakers, and when there was a customer service recording that was put on, ultimately it was in English.

So there were all kinds of hassles in order to get this thing through. So one has to look at sort of the overall context of these cards and what they may provide. As Oscar outlined a number of the features of the cards, those features are really illustrative. The cards can have one or more features.

They can be accessible through an ATM network or they might be only accessible at one ATM, let's say, located in a check casher's office. They might be available for point-of-sale transactions, those that involve a signature, or they may be available through point-of-sale transactions which involve the use of a PIN number or both.

They may offer drafts that you can utilize, such as the infamous convenience check, or you can draw against your account or they may not offer such services.

So there are a whole variety of different issues that kind of surround these cards, and in addition to kind of the four main Reg. E issues which are within sort of the province of the Board, that is, dealing with the loss of these convenience cards, unauthorized use of these cards, error resolution type issues, and the question of whether there are transactional statements and transactional receipts that are to be issued whenever these cards are utilized, there are a variety of other issues just to kind of give a context of problems or at least issues that come up with these cards.

One of the major ones is fees. Of course, the fees that may be associated with the use of these cards are not regulated, and utilization of the cards, in order to access your wages, you may find that you're surcharged a tremendous amount in fees.

Many state labor laws require that employees be able to obtain their wages without any charge from the employer. So some of these cards are set up to allow the employee to take a one-time draw on the card without any fees at all, and then fees are imposed.

So the initial transaction may, for example, allow the employee to take all of the money out from an employer based ATM or a check casher based ATM of the full amount, and then thereafter there not only will be charges, but the amounts that can be drawn out are limited so that an employee might only be able to draw $100 or $200 out in any given transaction.

So the question of fees are very significant. We've seen situations where payroll cards are teamed up an overdraft bounce protection type of plan so that employees then wind up in kind of a payday loan situation where they may draw begin their salary and then be subject to various credit and finance charges. And if the card that they're using does not give them transactional receipts and transactional statements, they may not have any real clue as to when they've exhausted their salary and when they've gone into the overdraft or bounce protection area.

There are some issues regarding financial privacy and whether information regarding the utilization of these cards can be used in particular ways, whether, for example, if the employee is buying a lot of prescription pharmaceuticals or whatever, there's an issue of whether they become a health risk to the employer.

There are issues regarding access to funds. As I said, some of the cards may be used through an ATM network, but some have very restricted points of access, let's say an ATM machine located at particular check cashers or at the employer's headquarters. So people may not be able to get access to their funds at convenient times.

There is also a question with regard to what happens to these cards when employment is terminated. Many employers will sort of shut off use to the cards, but employees may still have value that has been built up. As a matter of fact, since the great appeal of these cards is to the unbanked population, you may have people who are actually saving money and are building up value on their cards, and then if they get laid off or if they switch employment, they now have a card and they may not be able to get access to the money or they may not understand how they might be able to draw money out within whatever limited period of time the cards may still be good after employment is terminated.

There also is a question of how people can use money to make payments if the creditor or whoever the payee is going to be does not accept the card for payment. Someone, for example, may have difficulty taking money out of their wages using this card to pay the rent. If the landlord doesn't accept the card, the employee may have a payroll card that does not allow the employee to draw the entire amount of the payment out in cash to pay the landlord. There may need to be successive transactions to pull the money out. So it becomes sometimes very inconvenient to get access to money that way.

And finally, there are issues regarding the actual ownership of the funds and what actually happens to this money when the wages are paid. In some arrangements there are actually small accounts that are set up at a particular bank in the name of the employee, and the money is deposited into that account and money is drawn out through the card so that there is very clear ownership.

However, the typical transaction is one in which money remains in an account that is either set up by the employer or is set up by a service company that may be operating the system and the money is kind of aggregated sometimes in a very undifferentiated fashion in this account with varying levels of recordkeeping, and a contract has to indicate who the real employee is.

And this raises a couple of questions. One very simply is if the service company becomes insolvent or if the employer becomes insolvent and the funds are not properly segregated, there's going to be some real issue as to whether employees can trace their money in such a way as to be able to safeguard whatever money is there from claims of other creditors.

Secondly, there's the issue of FDIC protection. Clearly, if there's a separate account, FDIC will protect an individual account of an employee. The FDIC will also offer protection even in an aggregated account as long as there is sufficient documentation to show what I might loosely call a sub-account that belongs to each employee.

But if the recordkeeping is inadequate, the FDIC will not offer more than the $100,000 protection for the single account. So you theoretically could have a situation where you have a multimillion dollar account that represents unclaimed wages. The company goes bankrupt. A bunch of creditors try to seize the account or the bank becomes insolvent and there's a real question of how the employee's wages are protected.

MR. MARQUIS: Well, thank you for that impressive list of questions, which may lead to the conclusion that regulation is premature until those questions can be answered.

(Laughter.)

MR. MARQUIS: But, Agnes, do you have anything?

MS. SCANLAN: I was going to make an assumption, too, by his comments, and I'm assuming that Ron believes that while there are issues with payroll cards, because the payroll cards are so supportive to helping the unbanked that they still should be around, and with that I go right to the question of should payroll cards like traditional debit accounts be fully subject to the requirements, and I think that they should, and I'm thinking of this more as a consumer and more of the thought process of being able to support the unbanked.

Obviously there are issues. I agree with many of the issues that you raised, Ron, and I think that both the industry and the regulator should look at them, but I do think that these payroll cards are out there. They should be governed by this regulation.

They are the primary source of funds for many of the consumers. They fall within the congressional mandate that was given to the Fed. We were told a lot about this yesterday -- to keep pace with evolving products, with regard to recordkeeping and cleaning out accounts. This obviously falls into that category.

It's not necessarily a traditional account, but apparently when the reg. was put in place, it was to allow for the possibility of account that might fall within this matter, but not necessarily be a traditional banking account.

I also in our conversation yesterday, I think it was Elizabeth that eloquently paraphrased Larry's comments of the past: if it quacks like a duck, if it looks like a duck, it is a duck. Well, this looks like a debit and it should be governed by Regulation E.

If the product and if any product meets the definition of the law, it should be covered by the law.

And then lastly, while the Fed. reviews this, they should also clarify that payroll cards are covered and explain exactly what that means. We had a lot of conversation about what does an account mean. What does an account mean for the purposes of payroll cards?

MR. MARQUIS: Thank you.

Clint.

MR. WALKER: Yeah, I'd like to follow very quickly in what Agnes said without the word "clarify." I don't know much about payroll cards, but I think, Ron, you would admit that if they're done right, they can actually provide a lot of convenience to the customer. You know, without going to check cashing and you can get a wad of cash, you've got a card.

Safer; it has convenience. It hopefully will be a lot less cheaper than check cashing facilities.

That stated, what I'd like to address is the applicability of Reg. E to these cards, and you know, we heard from the staff yesterday they thought strongly that it should. We heard from Visa yesterday, who said the members who were issuing payroll cards were complying with Reg. E. They just thought it was the case.

I'd like to make two points in response to that. One, I think where Agnes was going at the end of what she was talking about, great care should be taken on how this defines what a payroll card is and what is applicable. Payroll cards could also include a card where a bonus is given to the employee, a $500 bonus where travel and entertainment reimbursement is done.

I would submit that that should not apply because I think that, for instance, the requirement of having to do all of the statements just doesn't make sense, and I think there has got to be a lot of care done in the finding.

Because you're going to create -- and this goes to my second point -- you're going to create the rules of the road, what type of product does comport and, you know, has to be governed by Reg. E and what doesn't, and you are, therefore, going to influence what is a developing market, and people will look at the rules that you create and design their products accordingly, and that will develop or design their own product.

I would urge that good care be taken in, you know, figuring out how this should work under the Reg. E role.

MR. MARQUIS: Thank you, Clint.

Anthony.

MR. ABBATE: Thank you. Ron, if I knew that you were going to put in such a case, I would have prepared a brief.

(Laughter.)

MR. ABBATE: So I'm going to have to scramble to address some of the issues that you brought up.

I think that some of the items that you mention about the use of a payroll card apply equally to conventional payroll accounts. Some of the same things that could happen in terms of bankruptcies, in terms of not having funds in the account, those can happen in a conventional way whether it's an electronic way or not.

In terms of what we're talking about in usage, we did get material that said that 10 percent of the people that could possibly use their card are using that today, and that 25 percent could use it in 2006.

But that was quoted from the company, a third party vendor who is supplying payroll cards to employees. So we don't know whether or not he's trying to puff it up or it's a real fact.

In the past the Board has made a determination about whether a law should apply and not act prematurely. I think that this particular usage of payroll cards has to be seasoned somewhat so that we know whether or not it's a real issue.

In terms of the fees not being regulated, well, you know, fees are between the issuer and the holder. The minute that it seems that somebody is going to make a buck to be recompensed for the services that they are providing, we want to regulate it.

The other issue is going back to the point about the 10 percent and 25 percent possible usage. Not all states allow an employee or an employer, rather, to select the means by which the employee receives payment for his services. For example, in the State of New Jersey, you cannot mandate that an individual receives his pay via an ACH to his checking account. The employee has the option to get a check.

We don't know how many states this applies to. So when we talk about the amount of usage, we have no way of knowing how many states have labor laws that forbid the use of payroll cards. Okay?

In terms of privacy, I think that's a stretch. If the person that's providing the service has to be discrete, he's not going to turn around and say, "Well, here's John Doe's account and he went 23 times to the pharmacy to get prescriptions." I think that's conjecture.

We don't know that to be a fact. In fact, and in terms of not getting enough cash to pay the landlord, by means of magnetic stripe on the back of the payroll card -- and I figured out by, I think, from conversation yesterday, that basically the average person has a $675 week take home. Well, all that needs to be done is that the card could be coded so that it would be good up to $750 for cash draw. It's done all the time.

Some banks have a normal amount of $500. Some banks have a normal amount of $1,000. So the employee is not going to be foreclosed from receiving the amount of money they need to take.

And the additional problem is that you also have third party issuers, and although they have to comply in the spirit and intent of the regulation, it doesn't necessarily mean that they have to follow it. All right?

So we have a problem here as right now there is an issue other than Visa who is a big player in the business. Now, if you go and you implement Regulation E, how in the heck do you know that that person is going to comply with Regulation E? Are you going to hand it to the Federal Trade Commission, which is underfunded and overworked?

No way in heck could they possibly regulate that. So I think that we're moving a little too fast. In the past the Board has been very deliberate in implementing regulation, and I think in this case that they should be equally as deliberate.

MR. MARQUIS: Thank you very much, Anthony.

Ken, then Pat.

MR. BORDELON: Thank you.

Directing to what Anthony said, they pretty much determine that payroll cards are covered by Reg. E now, and it's just a matter of implementing the reg.

We also heard from an industry representative who gave us a wide variety of the cards that are available out there in the form of stored value, which is what a payroll card is for, travel reimbursement, things of that nature.

We also heard from staff that when the Board looked at this years ago in '96, they did not want to stifle the development of stored-value cards, and I can understand that, but I'm wondering if, in effect, what we've done is, for example, I would like to issue payroll cards to some of my contractors for their contract employees, but I have concerns that if I have to comply, if we can clarify the definition of an account for USA patriot, for example, if I just wouldn't be better off offering a full blown debit card with an account relationship.

But I guess what I'm getting at is I don't think we fully understand the total implications of the Walmart settlement with the two card companies and where that is all taking stored-value cards. Stored-value cards are really being implemented outside of the financial industry world.

I heard stories a couple of weeks ago that there's a card out there called "Debit Man" that's used by several retailers that totally bypasses the financial institutions, and to me that's trying to get around Reg. E. If I've got a stored-value card that I don't have to have an account relationship, I don't have to have a statement to present to that cardholder every month, is Reg. E actually stifling competition? Should perhaps we look at stored-value cards in totality, not just payroll cards, at some set value?

I don't know, but it seems like we do have a conflict there that if we just try to carve out of the stored-value array of products one segment and call that payroll cards and that will be Reg. E and all the rest won't, I think you'll continue to see the market grow in the stored-value arena, but I think you'll see it outside of the financial industry world.

MR. MARQUIS: Thank you, Ken.

Pat.

MS. McCOY: Thank you, Oscar.

Right now we have a situation with payroll cards in which no disclosures are legally mandated. The large, reputable issuers do voluntarily make disclosures, but there are other issuers who make none, and we're talking about a population who is the population most at risk financially and who have their entire life savings tied up in these stored-value cards.

These same considerations cause the Board to look very carefully and regulate under EFTA electronic benefit transaction accounts, and I submit that these are really no different.

It's important to me to think about the timing of disclosures under EFTA. In many situations the employee when they first start employment will be given the opportunity opt between being paid by check or being paid by payroll card, and it's at this point that it's very important that the fee structure be disclosed.

I'm particularly concerned about the fees because in the neighborhoods where many of these people live, the bank that is the issuer of the card will not have ATMs, and so every time they access an ATM in their local neighborhood, they'll incur whatever fee that correspondent bank charges, and they can add up very, very quickly.

I certainly myself would not regulate the fees away, would not cap them, but I think it's essential to have disclosure and to make the disclosure up front when the employee is deciding which payment method to use.

Finally, this is not an EFTA issue, but I would like to have the Board think about in its discretion what disclosure should be made of the FDIC status of the funds and the payroll card. Are they within a separate account that belongs to the employee so that we're assured of FDIC coverage if it's with the bank? Is it in a payroll account aggregated at the employer's where you may only have partially or essentially no meaningful coverage?

That to me seems very important.

Thank you.

MR. MARQUIS: Thank you, Pat.

Earl.

MR. JAROLIMEK: Well, I just want to make an observation. Yesterday there was some discussion about, you know, who really is the financial institution. Some arrangements that we heard described would lead you to believe that it would be the employer.

So I think the issue of enforcement is going to be challenging, and that really where Reg. E comes into play and really makes a difference to the consumer is when there is a dispute or a problem, and you know, who's going to pony up and how will the contractual arrangements be between the employer and the institution, a bank, if you will, if, in fact, the employer truly is under Reg. E, the financial institution?

So I think there are some challenges there, before Reg. E gets applied. Some considerations on the various types of payroll card programs needs to be taken into account and determined who it really applies to and then how do you enforce it.

MR. MARQUIS: Well, and actually, if the employer is a financial institution, Gramm-Leach-Bliley applies as well, and the privacy notices and a lot of things come into play. And the notices, again, raise all the issues and problems that come with notices.

Diane.

MS. THOMPSON: What I have to say mostly underscores things that Ken and Pat said, which is that looking at the statute and the regulations, it appears pretty clear from the plain language that payroll cards should already be covered. They are very clearly a consumer asset account, as Pat mentioned, for the target population which have household incomes of $25,000 or less. Their payroll, their monthly or weekly or biweekly check is going to represent virtually all of the money and assets that they have access to, and that appears to bring it very clearly and squarely within what was meant by consumer asset account.

It's hard for me to imagine what else could be meant. There are regular transfers, electronic fund transfers in and out of these accounts. They're set up for that purpose. As Pat said, we already have coverage for electronic benefit transfer accounts. The government is already covered. These payroll cards are no different in the importance in the lives of the people that they are given to than the recipients of federal benefits who now receive them through electronic transfers.

It seems to me in terms of Regulation E coverage that there is simply no question but that payroll cards should be covered by Regulation E and probably are already.

In addition, we've had several industry people urge caution and a go slow approach, and I would ask the Board to move more quickly than that, certainly not without deliberation, but this is a matter that can't wait.

Ron has told, you know, one horror story. You can imagine many other horror stories, and currently on most of the issues that are important for consumers, Visa, who is the largest marketer of these cards, imposes on contractual obligations on the banks that it sells these payroll cards to, other than zero liability, but any of the other issues including disclosures, including when people get their money back, including the time limit and the notices for how to get your money out once you've been terminated from your employment, there are no contractual requirements imposed by Visa.

So this is really a wild area where people who are pretty vulnerable have absolutely no protection. It may be true in many states -- it's certainly not true in all states -- that the employer can't tell you how to take your paycheck. Even if that were true, that certainly doesn't prohibit informal coercion, saying, "This is how we're going to give your paycheck, and we expect it this way because this is much more convenient and cheaper for us."

And people who are earning $25,000 or less a year are not in a very good position to argue with their employers about how they're going to receive their pay.

We've heard from Pat and from Ron lots of concerns about the locations that people can get access to their money, the amounts that they can get access to their money. It's no answer to somebody whose paycheck is that way to say, "Well, the bank if they choose can set it up so that you can get more money." We don't know that, and they're not told that. There's no guarantee that they're even told that.

I don't think that low-income families can wait any great length of time to get their paychecks and to have guaranteed access to that paycheck, billing dispute resolutions, initial disclosures, and general information so that they know where, when, and how they're going to get paid.

Thank you.

MR. MARQUIS: Thank you.

Although I think we need to look at the alternative, which is getting a check and looking for a check cashing service, but --

MS. THOMPSON: And, Oscar, that may be true, but that's something that people have more control over. There are different options.

Pat yesterday made reference to a study from a few years ago that showed that most people are able to cash their payroll checks at the supermarket for no fee.

MR. MARQUIS: Ron.

CHAIRPERSON REITER: Well, I do think that there certainly may be a place for payroll cards, and as you point out, Oscar, depending upon how the payroll card arrangement is designed, it may be much more advantageous to the employee than receiving a check and going to a check casher.

A lot is going to depend upon how the program is designed, and I had mentioned in my earlier remarks a variety of issues that can arise in connection with design of the cards and the operation of a particular payroll card program.

One real concern here is that the market that is going to develop for these cards is not a market that is geared to the consumer, that is, to the employee here. This is not like a credit card where various features are going to be added and we're going to attract a customer, let's say, to a particular card because they offer frequent flyer miles or whatever.

This is something that is designed for the employer, to make the process of doing the payroll much more efficient and economical for the employer. So the employer is going to elect the system that is most advantageous to it, and that may very well result in the design that is not friendly to the employee who is going to get the card.

But putting all of that aside, there are certain things which the Board can deal with, and those main issues of Reg. E involving the loss of the card, the unauthorized use of the card, error resolution, and recordkeeping, in effect, through a general transactional receipt and transactional statements; these seem to me to be very critical in the payroll cards just as they are in a debt account.

And so the policy behind Reg. E seems to apply with special force in connection with the payroll card.

With regard to who the financial institution is as broadly defined, it may very well be, as Earl pointed out, that it is the employer, depending upon how this thing is set up, but I think there are ample means of enforcement that are available, and one doesn't decide that there should not be a law because the enforcement is not going to be perfect.

Particularly in this case of employers are the financial institution, there are state labor officials and other local officials who can look at this as well as the FTC and others.

And finally, I think the comments that Diane made are really directly on target. This seems to fall directly within the meaning of Reg. E. The only ambiguity is in the meaning of a customer asset account. An argument could be made that because the only two examples that are given are in the nature of deposit accounts, savings and checking account, that a consumer asset account is something that looks more like that rather than an account established somewhere that just has the employee's wages, but it's imbedded within a larger, undifferentiated account of the employer.

That's something that might be clarified to everyone's advantage, but it seems that the law does apply now. In order to avoid litigation, in order to help the industry design a product with Reg. E in mind, it seems that some clarification may be in order.

MR. MARQUIS: Thank you.

Anthony, do you agree with that?

(Laughter.)

MR. ABBATE: I do agree with a lot of the representations that Diane and Ron are making. The one thing is that I think we're overreacting, and let me say that, you know, you talk about fees at an ATM machine. They're certainly a lot cheaper than the five percent to pay the casher. In most cases you're worried about money and assets that are being kept in a stored-value card, but what happens when that individual goes to the check casher?

They take that cash and they put it in their pocket. All right? So what happens if they get mugged or they lose the money? It's far worse than they having it in a stored-value card, which is a heck of a lot safer medium. Okay?

In fact, I remember the definition of what banks do as being custodian of the people's idle funds. Well, listen. A stored-value card is acting as the custodian of their idle funds.

You also gave us a lot of hypotheticals about what people do and how they do it. I just wonder how much in tune you are with what the people you're talking about do in terms of their habits and the way they deal with it. Yes, a lot of people cash their checks at supermarkets, but in a lot of areas, low-income areas where people do the most business is at the local grocery store, they run up a tab. Am I right? And when they get paid, they go and settle the tab, and the grocer cashes their check.

The grocer is their banker. In many instances, in many neighborhoods, the grocer issues money orders. They buy money orders, and that's how they pay their bills.

I would venture to say that people of that particular representation that have a payroll card are going to take all of their cash and do everything that they've always done in the past. Okay?

I also think you have to look at the fact of who's going to govern the payment of the person's salary. Now, in most states labor is covered by the state's Attorney General. In this case if there's an issue about all of the things that you brought up about people not getting paid, people doing this and the other thing, there's a complaint that's going to get filed with the state AG, and I think that the business is going to feel the wrath of the state on the fact that they didn't do the right thing.

So I think in some of the things that we're thinking about, we're going a little far afield and we're hypothesizing things that we don't know are actually facts, and that's the reason why I made the statement that we need to go slow before we go fast, one step at a time.

This is an immediate reaction. I mean, Ron, you mentioned horror stories. Well, there are a million people as we've been told that are using payroll cards. Out of the million people how many horror stories have there been? What is the percentage of the whole?

I mean one out of a million? That's de minimis. So all I'm saying is that I think we have to go slowly.

MR. MARQUIS: Thank you.

And of course, the other question is would the horror stories have been solved by having Reg. E coverage, but let's go in order.

Dan.

MR. DIXON: Just quickly, now that we've pretty well covered the glass is half empty side, my company is not generally in the commercial banking services business. So I can't really speak to some of these issues from the standpoint of a bank that might be a supplier.

But just in listening to the rest of the discussion, it seems to me like the payroll card has huge potential for positive good for folks that would otherwise be unbanked, and I would encourage as part of any process that does get started here that we spend the time to look at it from that standpoint.

How can this be facilitated in a positive, helpful, constructive, responsible way?

I mean, what my company does do is mortgage lending, which is a highly regulated enterprise and for which we're grateful. The problems in many of these business lines come when there are those that are not subject to regulation that create problems for the rest of us that might otherwise behave appropriately anyway.

I suspect that this may be an example for which there could theoretically be a lot of small business type employers, and frequently regulations exempt the smallest companies anyway, and so I think there's a lot of related issues that would need to get sorted out, but the bottom line is it could be viewed as a very big positive opportunity.

MR. MARQUIS: Thank you.

Elizabeth.

MS. RENUART: To respond to a couple of remarks that were made earlier, one is the distinction between stored-value cards and payroll cards. In other words, if the Board opines and the staff opines that, yes, indeed, what appears to be true under the Regulation E is true, and that is that payroll cards are covered, are we cutting too broad of a swath? Are we going to bring in stored-value cards as well and that's a whole other area?

And I think the answer to that is no because of the definition under Regulation E presently, and that is that the account has to be held for a particular consumer, directly or indirectly, by whatever the institution is, "institutions" defined broadly.

So stored-value cards are clearly on one side of the fence because they aren't attributed to a particular consumer. You buy them. You're anonymous as far as the vendor is concerned, and you just use it at Starbuck's or wherever at will, and if you lose it, it's like cash. That's your problem, but it's not an account that has your name on it anywhere.

Whereas payroll cards are very different. They do have this identification. There's a specific amount for a specific employee, and you can only draw up to that amount, and that's it, and that's either specially held in your name as your own account with the bank or, again, as Ron mentioned, commingled with the funds of the employer in its one larger account.

But in any event, there's a line item that is your name and it's a particular consumer that's identified. So I don't think the Board has to worry about getting into the stored-value quagmire by stating what is to me clear under the regulation now, and that these types of payroll cards are presently covered.

In terms of enforcement, which Anthony just mentioned, enforcement is no better or no worse under Regulation E than it is under Regulation B, Regulation Z, any of the other regulations where there's a private right of action for a consumer to enforce it against whoever violates it, and there's federal enforcement through the FTC.

So however good those systems are for the rest of us under all of the other regulations, they're just as good under Regulation E. So personally I don't see that as a reason to say we should go slow of that consumers can't enforce their rights against banks or nonbanks in the event that something happens to their card or some other fraud or unauthorized use occurs.

MR. MARQUIS: Thank you.

Connie.

MS. CHAMBERLIN: Thanks, Oscar.

A number of people have talked about the value of payroll cards, and I really don't think that there's any argument about the potential value of payroll cards and the potential they have for doing something to reach that group of people who are not banked.

I think the only thing we're talking about is whether or not there is a need to protect the consumers, and I would say in the discussion of going slow that it's my understanding the Board first addressed this in 1996. That was seven years ago. I think we've already gone slow, and we've had that seven years, and that perhaps it's time to speed up the process a little bit.

CHAIRPERSON REITER: Oscar, I think you need to wrap up the discussion.

MR. MARQUIS: Okay. Well, actually you were next on the list, but --

CHAIRPERSON REITER: Well, then --

(Laughter.)

CHAIRPERSON REITER: With that one exception, of course.

MR. MARQUIS: But are we done?

(Laughter.)

CHAIRPERSON REITER: Can I just take 30 seconds?

MR. MARQUIS: You can take 30 seconds.

CHAIRPERSON REITER: That's the Chair's prerogative, you know.

I don't think it's necessary to speculate on human behavior and how people will use these cards, nor do I think we need to speculate much on how these cards may develop. It's very difficult to imagine any type of reasonable payroll card which would not have some mechanism to deal with the loss of the card, the unauthorized use of the card, resolving errors.

I mean, you can just imagine you have your payroll card and you charge $10 and they deduct $100 from your card. There needs to be some method for resolving that kind of error.

And likewise, it's certainly desirable to have some sort of recordkeeping with respect to these cards. It's very difficult to differentiate a card and an account that is set up in which your wages are deposited, a card that is given to you upon which you can draw governmental benefits, and an account that you may set up, a savings account that you may set up where you can access it with a debit card.

All of these kinds of cards have very similar features with respect to the basic Regulation E issues of a method for dealing with the loss of the card, unauthorized use, and error resolution. Given the breadth of the definition already in Reg. E, it seems both logical from a policy standpoint and also just from the wording of the existing statute to apply Reg. E to this, and if a clarification is necessary, it might be desirable rather than having the matter resolved in the courts.

MR. MARQUIS: Thank you, Ron.

So I think we've all agreed that the regulation would be very complex and it's either premature or late.

(Laughter.)

CHAIRPERSON REITER: Or necessary or ill advised.

MR. MARQUIS: Yes, right. So thank you very much.

This is actually my last meeting, and I want to thank the Board for giving me this opportunity to serve on the Council. I've enjoyed my three years.

I particularly am impressed with the staff. I found that they were very, very knowledgeable, informed, articulate, sincere. They really want to do the right thing, and I'm very impressed with the staff.

Dolores, thank you very much for having me on the Board. I hope I didn't cause too much trouble.

And I also enjoyed serving with my fellow Council members. Thank you very much.

CHAIRPERSON REITER: Thank you, Oscar.

We will now turn to remarks from two of our Council members. I'd like to start with Anthony Abbate.

MR. ABBATE: I'd like to take the opportunity to address the matter of the regulatory burden which long has been an issue among community banks. Thankfully, the Fed. has begun to focus on some of them.

Regulatory burden is enormous and has a disproportionate impact on the majority of community banks due to their limited human, financial, and other resources. Examiners review 26 different consumer compliance regulations. While each regulation by itself may not be overly burdensome, there is a cumulative effect.

This burden has caused some community bankers to consider whether or not it might be more prudent to sell. The loss of a community bank has a tremendous impact on local communities. Studies have shown distant financial institutions participate and contribute far less than those in the local community.

As Congress enacts additional legislation that affects banks, such as the USA Patriot Act and the Sarbanes-Oxley Act, the burden only grows and never decreases.

Part of the problem is that Congress often overreacts to a problem and creates more a regulatory burden for banks. Is there some way that the Fed.'s lobbyists could have influence over the process and temper the actions of Congress?

What began as a fairly straightforward process has become an enormous burden. The CRA compliance examination process is much lengthier and much more burdensome than a safety and soundness examination and has resolved into a numbers game.

More important, there are costs involved with regulation. Without thorough analysis and careful balancing of costs against benefits, bank products and services will become increasingly expensive, and no matter how much outreach there is to low- and moderate-income communities, consumers will be priced out of the market and find bank products and services less accessible. For example, compliance with HMDA and RESPA has helped increase the cost of real estate lending. Much more careful attention to regulatory burdens and costs is needed to insure the industry can continue to provide products and services at reasonable costs to all consumers.

Why are the regulations burdensome? Regulations are not written in plain English. This often causes confusion among bankers and examiners. Too many disclosures to consumers are required that are complex, difficult to understand, and often ignored by consumers. For example, the disclosures issued under the Truth and Savings Act and the Gramm-Leach-Bliley Act.

Privacy requirements often end up in a wastebasket while RESPA disclosures are not serving their purpose.

Consistency in application of regulatory requirements is critical among regulatory definitions, among regulatory agencies, between Washington and regional offices, and between agency regions.

For example, one topic that has been discussed by the CAC is a uniform definition of the business day. The definition of a business day is different in Regulation E, electronic funds transfers, Regulation CC, expedited funds availability, and Regulation Z, truth in lending.

The Board should strive to conform the definitions by regulation or by asking Congress to act. This seems to be the type of step contemplated by the Economic Growth and Recovery Regulatory Paperwork Reduction Act of 1996.

Every regulator requires written policies and procedures. Someone at the company has to find time to whether or not it's applicable to the particular bank's operations.

Examiners often ask for policies and procedures that are irrelevant to a bank's operations, but responding to the examiners takes time and effort. Regulations often impair customer service. Restrictions on NOW account eligibility, the right of rescission under Regulation Z. Truth in savings eliminates options for customers, such as combined statements and types of accounts.

Time spent on compliance detracts from helping customers. The exam procedure itself can be burdensome. There's a need for consistent communications, a need to focus on the individual bank's operations, a need for the agencies to consider both sides in a dispute between banker and examiners.

Application of CRA standards can make it difficult to earn an outstanding rating and compliance resources are often disproportionate to the benefits. As a result, some banks are content to earn the gentleman's C and not make the extra effort.

Moreover, CRA standards distort bank community efforts with banks and their employees abandoning efforts that may have a positive effect on the community, but they don't result in CRA credit.

There should be a uniform standard for what constitutes clear and conspicuous disclosures in the regulations, implementing the various consumer financial services laws. For example, language describing the standard for providing privacy notices for the clear and concise application to the Truth in Lending Act disclosures.

Regulators should hold focus groups with consumers to insure they understand them. One bank held focus group for their privacy notice disclosures, and the only sections universally criticized by consumers in these groups were those sections mandated by the regulations.

I'd like to offer some suggestions for improvement. Eliminate some of the regulatory burden for those banks that are rated either Campbell 1, strong (phonetic) or Campbell 2, good. Banks that are managed well should have some regulatory relief even only through simplified examinations.

Continue building a tiered regulatory and supervisory system that recognizes the differences between local and regional community banks and larger, more complex institutions, say, the top 100 which pose the greatest systemic risk.

Eliminate unnecessary consumer disclosures. Insure that the disclosures are meaningful for consumers.

Simplify the regulations by writing them in plain English so that both bankers and examiners can understand them. Increase the use of best practices in question and answer guidance. Strive for greater consistency between regulations, agencies, and examiners.

It would be helpful if the agencies bore in mind the functionality impact of different regulations and, if possible, coordinate regulation requirements.

For example, when a customer comes into a branch to apply for a car loan, there is no single lending rule. Rather there is a myriad of regulatory requirements that affect each bank product or service. For example, many banks offer money market deposit accounts. A list of all the regulations that apply to such an account would be extremely useful, or if a bank offers a home equity line of credit, the regulators would provide a checklist of all the regulations that a bank compliance officer and examiner need to consider to insure that the bank offers that home equity line in compliance with federal banking requirements.

Having participated in the Consumer Advisory Council has been a rewarding experience for me these past three years. I would like to also offer some suggestions concerning the composition of the Council.

I believe consideration should be given to individuals with bank operations experience since I have observed that there were very few members who have had hands-on experience as to the complexity of implementing regulations.

Consideration should be given to those folks that understand bank information technology systems, as well. This will be increasingly important as we move into the 21st Century, but the impact of regulatory operations needs to be understood in order for the CAC to have a meaningful discussion.

Also, I believe that consideration should be given to the diversity of the communities throughout the U.S. and the financial institutions that serve them. We should recognize that not all communities are urban and not all consumer issues are those faced by inner city residents.

There are many rural and suburban areas across the nation with unique problems, and the views of these consumers in the communities also must be reflected on the CAC if the CAC is to force a balanced perspective.

It is very important that the membership of the CAC reflect this diversity. Too great representation of consumer activists will skew the views of the CAC and fail to offer the perspective that is vitally needed if the CAC is to remain meaningful.

Representation of too many compliance and CRA officers does not solve the diversity issue because they have a narrow focus steeped in the regulations and constraints that inhibit their ability to truly represent their banking constituents.

These viewpoints are critical for balanced discussion, but neither should become the predominant voice in the make up of the Council. For example, while possibly not practical, having a typical consumer/bank customer on the CAC would be helpful. Other perspectives to consider in CAC deliberations are marketers service providers, vendors, software companies, and so forth.

In conclusion, serving on the CAC was a broadening experience, and the interaction was terrific with the members. The support of the staff who were all professional and very knowledgeable in consumer banking is very much appreciated.

Everyone worked to crystalize and clarify many issues before the CAC. In the end, I have come away with a fine appreciation of consumer matters that I shared with my official staff. Hopefully it will serve to enhance the services that we provide to the communities we serve.

Thank you.

CHAIRPERSON REITER: Thank you, Anthony.

We turn now to Elizabeth.

GOVERNOR BIES: Mr. Chairman, can I just interrupt and make one comment?

I just didn't want to let the opportunity go by about regulatory burden to pass without asking that you actively participate in what's going on right now. I think you're aware that for the first time all five depository regulators are jointly going out for comment specifically on regulatory burden, and we're doing it instead of reg. by reg., we're doing it by area of coverage so that we get all of this overlap and redundancy and try to elevate it.

And we started this effort this summer. It's going to be rolling out over the next year topic by topic, and the more you can get involved and encourage your fellow bankers to get involved, I think it would be very important.

But what you're saying is what we're trying to do in this process, and any feedback you can even give on the process would be very helpful because we have heard the issue, but this is the first time that we'll be looking at like all of the consumer issues together, all of the bank capital stuff together. It will be by topic.

So please give us specifics on specific regs. where there are implementation issues or where you feel they're obsolete or redundant. The more specific then we'll be able to take action a lot easier both from regulation or if we need to go to the Congress for other changes.

But I don't want to pass the opportunity. I really would like your input on that.

MR. ABBATE: Thank you very much.

CHAIRPERSON REITER: Elizabeth.

MS. RENUART: Well, as Anthony's foil, I would like to address the issue of additional regulation.

(Laughter.)

MR. ABBATE: Why didn't I think that would happen?

MS. RENUART: We didn't plan this.

Handed out to you should be a slip of paper that is entitled "Important Actions that the Federal Reserve Board could Take Under its FTC Act Authority."

And just a little history about why I've decided and appreciate the opportunity to have a few moments to speak about this substantive matter is that the Board does have authority under the FTC Act specifically to promulgate regulations prohibiting unfair or deceptive practices for banks, both national banks, Federal Reserve Board member banks, as well as state charter banks that are FDIC insured.

And, in fact, it's not just that the Board has the authority to do it. The Board is mandated to do it in certain circumstances, and that is the Board is mandated once the FTC files or finally enacts a set of regulations, the Board must mirror those regulations within 60 days.

So the Board has two kinds of authority: one, do it on its own or your own, as well as to piggyback onto what the FTC has done, and the Board has mirrored the FTC credit practices rule, and I've given you the citations for that, but one action that the Board has not taken, and that is the Board has not adopted the FTC holder rule.

And what the FTC holder rule says is that when there are goods sold and there's a credit transaction as well, any holder of the credit contract that financed the sale of those goods ought to have in it a notice that says that the holder is subject to the claims and defenses of the consumer who purchased those goods and services.

And so I have suggested action for the Board to take, which is to adopt the FTC holder rule and add with that that the failure to include the notice does not insulate the holder from the effects of the rule because basically under the FTC version of the rule, some states do have this rule in place otherwise, but as we know, state laws typically aren't being applied to banks these days because of the preemption doctrine, but many states haven't incorporated the FTC rule into state law either.

But the FTC rule is not self-enforcing in the sense that if it is in the contract, then it's a matter of contract law that it can be enforced, but if it's not in the contract, it's up in the air as to whether because it's mandated by law, you know, it's considered a silent member of the contract, a silent provision and, therefore, can be enforced or because it's absent it's not a part of the contract and, therefore, cannot be enforced.

And why does this matter for banks? Because, again, your authority only extends to unfair and deceptive practices at least under this act with respect to banks, and that is there are instances where banks are the originating lender to fund home-improvement work that's done. That's the sale of goods, and so the FTC holder notice ought to be in that transaction where the home-improvement contractor has a referral relationship with the bank, and that has certainly happened over the years.

In addition, a particularly interesting example that recently came to my attention is in the area of student loans. The purchase of an education through a student loan is considered a good or a service that's covered, would be covered by the FTC holder rule, and there is a national bank that's funding unfortunately student loans for people to go to institutions that are not properly accredited or licensed, and therefore, they're operating illegally.

And that banks is saying, well, the FTC holder rule is not in our contract. So you, student, can't come against us, bank, if they close their doors or they're not giving you an education that's properly accredited or they're not licensed.

So whatever defenses you have against the school, you cannot raise against the bank.

So I would urge the Board to think about this and to adopt the FTC holder rule, as I have mentioned.

A couple of other suggestions which I'll just go through quickly. The Board would have the authority under this general FTC authority to adopt a rule of prohibiting the taking of a check or an agreement to an electronic debit as a security for part of that loan transaction, and basically what this would do for banks is prohibit the ability to make payday loans.

And there are still banks within the Board's authority that are making payday loans. Some of them have stopped due to OCC intervention on safety and soundness grounds. They were never unfair and deceptive grounds, but on safety and soundness grounds, but there are still banks making payday loans that range from 391 percent on up. I have seen one that was 6,000 percent APR, and that's because the term was short and the amount of the fees that was charged was large.

So these kinds of loans that have no relationship to ability to repay, which is clearly a safety and soundness issue, in my view if the Board took this one particular action, that would settle the matter and banks would not be involved in this business.

And lastly, of course, this one would be the most controversial, I would think, and that is adopting a rule prohibiting the charging or financing of a certain amount of points and fees, particularly in mortgage transactions.

And my view is that the reason why there has been flipping either by banks who have originated loans or banks who purchase these loans on the secondary market or derive other certain amounts of income from predatory loans is that the flipping strips and why that occurs is because the points and fees are financed, and I'm not asking necessarily to regulate the amount of the fees, but if they could simply not be financed above a certain percentage, that will greatly reduce the incentive to strip equity out of homes, as well as to flip loans.

And then procedurally, I just again, like Anthony, wanted to thank both the Governors and the staff and Dolores, as well as my colleagues, for this wonderful three years that I've had learning from you and growing and hopefully contributing something to the Council as well.

And for me it has been a rare opportunity. I just wanted to sort of look at the micro of what we have done as well as the macro. Speaking to some economists in the room, maybe those terms will draw your attention to it.

And that is on the micro level, we look at laws and, you know, the exceptions from them and when they apply and what the loan products are, and we have gone around about those. We have looked at CRA and how that enhances in some ways and sometimes doesn't enhance increased lending in certain communities, and we've looked at the importance of the aggregate transparency we achieve through HMDA, and the Board has expanded the collection of data under HMDA, to your credit. And those things have been very important to me.

In addition, what this has helped me to see, and there's certainly hot debate about how we would come out on this issue, but on the micro level, I think this Council provides a very wonderful forum to at least think through. We don't necessarily discuss this all the time openly, but what we're really doing here is, given the ascendancy or the rise of deregulation, the stripping away of regulation that has occurred over the years despite some claims that some industries are too regulated, federal preemption, the inability of states to govern and to assist their citizens at least with respect to certain types of financial institutions, mandatory arbitration which shunts the cases away from the court so that there's not the light of day in judicial proceedings for what's going on, and in my view, Wall Street's recent intervention in state politics by coming down hard in terms of what bonds they will rate, what types of loans they would rate for securitizations which has derailed or affected state legislation.

To what extent -- and I'm just asking people to think about this over time and maybe to have additional conversations -- to what extent do these developments really contribute to weakening our republican form of government and ultimately undermining our democracy?

So with that grandiose view of really what we're talking about here on the large level, although we are usually focused on the small level, I just thank you very much for the opportunity to participate in all of those discussions, both the micro and the macro, and I apologize that I have to leave to catch a plane because I have to go to California, and I can't chat with many of you during lunch, and I tried to make the rounds and shake your hands and thank you at the break, and I missed quite a few of you and I apologize about that, but I really enjoyed my time here.

So thank you.

CHAIRPERSON REITER: Thank you, Elizabeth.

Governor Gramlich.

GOVERNOR GRAMLICH: Yes. Well, this is, I guess, a diploma ceremony of sorts, and typically we add the honors at lunch, but apparently not everybody can be at lunch. So let me just say a few words, too.

I am not going to wade into the policy disputes that you've just heard about, but you have all mentioned that this has been an opportunity for you, and it's obviously an opportunity for us, too. Of all of the committees the Board has, this is far and away the most diverse, maybe not diverse enough for Anthony, but it is quite diverse, and we worry about that in our selections. It's the committee that most has different views represented right here at the table. Rather than have industry representatives or whatever uniformly bang on us, you all get together and bang on each other.

(Laughter.)

GOVERNOR GRAMLICH: And that is not only more pleasant, but it's also more illuminating because you know the arguments better than we do.

And I know that you all spend a lot of time with this in preparation and so forth, and we do appreciate it. We're obviously not going to make everybody happy on the policy level on every issue. We do try to listen to what you say and go through it seriously and make the judgments as best we can.

And the two statements we've just had, we will certainly do that and consider alternatives in the usual way.

So I, too, speaking on behalf of the Board, I would like to thank you for your efforts and your sensible comments, and your participation as well, and hope we can keep this institution going.

And lastly, let me say that we are quite appreciative of our staff as well. So thank all of you and thank the staff.

CHAIRPERSON REITER: Thank you, Governor.

We'd like to turn now to presentations by some of our members. First, Ken Bordelon.

MR. BORDELON: Ruhi is first.

CHAIRPERSON REITER: Ruhi, are you going first? That's fine.

MS. MAKER: Can everyone hear me and see me? And I don't know how these -- oh, there. That's how the fancy pointer works.

I was asked -- Ann called a few weeks ago and asked and apparently Agnes suggested that we walk you through the work we do. I am an attorney with the Public Interest Law Office of Rochester, and I convened the Greater Rochester Community Reinvestment Coalition in upstate New York, in Rochester, and that coalition has been in existence for over ten years now, and part of what we do is we comment on mergers obviously, but we also comment on exams.

There are about eight depository institutions in Rochester, and we comment on the exams, and this is a sample taken from the exam.

Can you show the next slide?

It's about a 40-page letter that we just completed. We've redacted the name of the bank for purposes of anonymity, and I'm going to walk you through what we look at, and what the process is that we are involved in.

The coalition, as I was mentioning to someone, it's about, oh, 30 members. It's the usual Urban League, NHS, Enterprise, you name it. There are just about all the not-for-profits in Rochester are members of the coalition.

And somebody commented it must be like herding wild cats, and in fact, it's not. We work very, very amicably together, and I sort of account for that by the fact that most of the executive directors of the organizations I work for are women, but there isn't a lot of ego involved, and I think there is a real recognition that there is value to be added in working together and not being competitive and seeing this as a constructive dialogue.

And that has always been what we have felt that this should be all about. So we comment on mergers. We comment on the exam, and I think one of the things somebody mentioned to me is we meet with the banks when they have an exam, and I'll walk you through what we do, but we meet with them every year whether or not they have an exam.

And the data analysis that you'll see that we do, we do that every single year for all of the banks that we look at, and actually we look at a couple of credit unions as well now.

And when we first started doing it, you know, I remember in the early '90s there was no mapping software, and I sat at my kitchen table with my three year old running around coloring in the maps by hand.

You'll see the maps right at the end. Now we use the LAR data, which is the loan applicant registry data that we get, you know, in July when the HMDA data comes out, and we spill it into Access and we kind of take it from there.

So we first got the data, and you'll see some of the kinds of tables we do, and then we meet with the banks, and we say, "Here's how we've cut the data, and you know, what have we gotten wrong and what have we gotten right?"

And we have a meeting. We have a dialogue usually in person and then usually some of the senior staff of the bank are in another city. We have them on by conference call.

We draft a letter. We share the letter with the bank then, again, for comments, and then at some point in the process, depending on the timing, we meet with the regulatory staff. Obviously there are a lot of big banks in Rochester that are Fed. examined. We work very closely with the New York Fed.

And I think we realize that -- I think the New York Fed. has realized some of the value, what we do. Before we get a chance to call and say, "Oh, you're going to examine X," they call us now. So we hope that that's useful for them.

We contact the coalition members to talk about what their needs are, and obviously this year we're going to do about four exams, and we do an ongoing process. We look at mothballed HMDA data, Home Mortgage Disclosure Act data. We look at small business data, and we do some mapping.

So can we have the next slide? Sorry. I just walked through that HMDA and small business.

What do we look at when we do the HMDA analysis? We look at the mortgage. We look at market share. We look at how many home purchase loans are made, how many home improvements, how many refi's. We have some tables we'll see in a minute, and we track it back. Our earliest data set goes back to 1991, and you will see a time longitudinal chart in a minute, but we can go back and we can say to a CRA officer who may be new to the bank that when you X works with Y in 1995, this is what you did and now this is what you're doing post merger.

So that's something we look at fairly closely. I think we're going to see in a second a chart that we -- and, by the way, copies of the presentation are in back. You can get them as you leave.

This is a chart that we've created and we've used. We have charts that look like this again going back about ten years, and this compares the largest depository institutions.

For those of you who use CRA list, you'll get your little market share and you'll have like 100, you know, lenders, all of the lenders in there. What we do with this particular chart -- and I'll try and work this little pen -- is we look at mortgage originations, and this is for 2001, and we look at the top eight depositories in Rochester, and some of you will see, you know, Chase, Citibank. You know, some of the ones you'll recognize, and these are mostly the large institutions, and we look at the numbers by the metropolitan statistical area. We look at the absolute numbers of total loans in the city. Then we look at geography by MSA low-income households and low-income census tracts, and we look at minority census tracts. Those are sort of the categories.

And then, you know, you put the numbers into an Excel chart, and this gives you the market share. And what are we essentially looking at? I mean I'll choose and look at -- oh, I don't know -- I'll pick HSBC for example, and what we're looking at is Fleet has or HSBC has a 13 percent market share in the MSA, and what we're looking to see is is their market share comparable or higher in the city.

And as you look down what we call the CRA, the underserved communities, you'll see that in the city Fleet's market share is 15 percent, which is greater than 13 percent of black, Hispanics, from households is 12 percent, which is comparable. It's the low-mod. households are 16. Minority census tracts is 15 percent.

And what we're looking to see is that, you know, they're tracking the lending that they're doing in these communities, in the underserved communities that they do in the MSA. And that gives us kind of a little threshold to look at and lets us compare across the eight depositories in this case. It shows us what the top eight depositories did in the MSA and then down these different regions and what the other financial institutions did.

Now, as I said, we have this data for going back. You know, when I first started looking at it, it was over 50 percent. Then you saw a surge in subprime lending, and these numbers fell. This top eight number fell to about 30 percent, and now it has climbed back up, and we have done the same chart for credit unions. We've done the same chart for the 10, 15 largest subprime lenders which is a similar chart that we have.

And, again, we have the data going back for subprime through '96. So we're able to track what has been happening historically.

The last line looks at what your lending is as a percentage in the city, you know, black, Hispanic, et cetera, and time doesn't permit me to go into great detail, but you know, this gives you a general idea, and this is a chart we've created ourselves, which we don't use CRA with. We use the raw data, and for us this works better as we do the analysis.

So can we look at the next slide and maybe, Ron, you can keep me on track here, and this I'll go through very, very quickly. This is looking at prime total mortgage originations for this lender. Again, we're tracking this across time, for example.

So we're looking at, okay, what was the change between '01 and '02, and then we're looking at what was the change between '94 and '02 and how lending went up in absolute numbers over that period of time, and you can sort of do a little trajectory, and then, of course, you can turn this into little charts and bar graphs as well.

And so, you know, we're looking. In this case this was for an exam. We would do something very similar for a merger. You can say to the lender here's where you're growing. Here's where you need to grow, and you know, I sort of joke about the fact that I was talking to a colleague of mine.

Can we go on to the next slide?

I was saying, "Well, I think I add value to the lender, where I examine at the micro level and say, 'Here's what you're doing and here's how you can improve,' and it's a constructive process."

And she joked and said, "Well, I still think they wish you would go away."

But my goal is one day they will say, "Hey, you know, this actually helps me."

We do something similar for the dollar amount. We do the same thing and -- next slide. I'm going to flip through these slides really quickly -- we do the same thing for home purchase lending. You know, there are about 10 or 15 charts like that in any exam letter that we do, and so we do the same thing for home-purchase lending.

You know, if it's a refi. big year, we might do it for refi.

So can we keep going?

Also, there has been a lot of discussion about purchases and, you know, how to look at purchases or originations. We are now starting to pull that out, and we'll look and see and say, "Oh, well, this person" -- in this particular case there was a lot of discussion about who the bank purchased their loans from and who they sold to. So we may have a detailed discussion of that level about the bank.

So then, of course, the very interesting information that we look at is application and denial information. Again, we've been tracking this ten-plus years, and we can show where you've been and where you come from and, you know, we've seen some real interesting changes.

You know, we break it out by race, African American, Hispanic. We look at white applicants, and the race unknown, for example, we saw a huge jump in race unknown, which we hope will change with the new changes in how the data is gathered.

We look at denial rates over time, and I'm not giving you a flavor of some of the substance we go into, but we'll talk about how do you do second review. How do you underwrite them?

When we first started meeting, we would talk about, you know, for people with no credit. How do you underwrite when people don't have credit? You look at their utility records and things that are fairly obviously done now were dialogues that we had, you know, ten years ago.

And so can we have the next slide?

And so this is giving you a quick idea of, you know, what are the total number of applications? For example, we saw in this particular bank's case, you know, the race unknown was a huge jump in 2001, if you look at right here. You know, a lot of the applications in 2001 were race unknowns. So we'll talk about what happened, how did that go. That will, you know, go away as an issue.

And then we look at track and see, okay, how is your denial rate changed. You know, it has gone up; it has gone down. What are the total applications?

So one of the issues we'll say is, "Look. You only had 127 black applications," as far as we can tell because, of course, there's a race unknown number. How do we factor that in? How do you market to your community? How do you market to different communities? And we talk about some of those things.

Can we keep going?

Then we do the maps. We have a lot of maps, and I'll show you a couple of examples. We map by loan type at the census track level, the number of loans, what the total market share is, and we look at lending in minority census tracks.

So we'll look at a map, and this is the City of Rochester, and essentially the red is where, you know, that's where you didn't do too many loans, and that's where we focus on where you did or didn't do. The green is where you did a lot of loans. In a minute you'll see the next map, and this is the market share map.

For home purchase we have a total map, total lending, refi's. We have a map for home-improvement loan if that's the case, and then we'll have a map that looks at this for the top eight depositories. We'll have a map that compares, you know, for all lenders in that particular year in this geography.

And then we have the blue area that looks at the minority census tracts to see where you're lending, and so you can essentially set a map aside. You can look at this and see how you did in comparison to all 100 reporters in this geography, how you did compared to the other depositories in this geography, and you can get a pretty good idea of saying, "Well, Bank A, you're all red here. Look at this. Here's where all of the subprime lenders are lending."

So when we first started cutting the subprime maps, we would see that the top eight weren't penetrating, and that's where the subprime were penetrating, and that's where we were able to talk about potential market opportunities.

Can we keep going?

And one of the things I want to talk about, I love maps. I've always really, really loved maps, and I know I've used them in mergers and I've had, you know, at the New York State Banking Department someone come up to me and, you know, talk about how they tell the story.

What we are now looking at is, because the 2000 data just came out, and the income data for 2000 census came out just this March, and now we can track, and we have actually mapped at the block group level. We've created these maps which show by race and by poverty.

So we can show at the block group level how many black women with children under five there are who are below poverty, who are above poverty. We can do that for Hispanics, whites. We can do it for women with kids under five and five to 17.

Now, you cross-hatch that with income, and essentially what you have is your marketing opportunity because you can look at what the income level is. So when you're saying, "I want to work with this particular community group," you can identify the community group where you have X number of women who are parents who are making $30,000 a year, but who are still renters.

And you think, okay, and in Rochester where housing prices are average, around $40,000, that's someone who can become a homeowner. You can have the absolute number at the block group level where you can say, "I will work with Group 14621, and I will work with these particular block groups to do this kind of marketing, which is, I think, potentially an enormous tool as we try and essentially turn some of these people into homeowners.

So because the census data just came out, we've started to do some of these maps. I think they, in fact, -- some of them already exist, and we're going to be using that.

So our role is, you know, we're like free consultants, and of course, we're commenting to the Fed. when we're doing this or we're sharing this information with you, but you know, use us as a tool, and that's the model that we hope the banks will eventually or some of them I think do appreciate.

I know that the CRA officers seem to think that there's some value in what we do.

We do the same thing -- I'm going to keep running because I know we're short on time. You know, we do the same thing for small business data. In '96 when the data became available, we did maps of small business data. We did, you know -- we pulled employer data and we mapped some of that. So you know, we look at the usual things that are available with small business data.

Can we keep going?

And so there's a market share for small business again, the same or similar to the one we had earlier, and we'll keep going. Then the thing that we do is we do essentially a community needs section. You know, it runs pages and pages and pages long where we talk about here's what are the community needs in Rochester, and we talk about the MSA.

And then we talk about what the bank has done, and we sort of not critique so much, but for like feedback as to the value in the community development activity that the bank has done, although this whatever activity is.

So we say this is great; keep doing it. This is what a need is. This is how you can change. This is how you can refine, and then, you know, we do that obviously at the very micro level with the lender, as well.

And I think is that it? I don't know whether we have -- oh, here are a couple of examples that I was talking about. I think at some point I was talking about the Greater Rochester Housing Partnership Tax Fund when I was talking earlier.

I have three minutes, and I think this is my last couple of slides.

This was one of these funds which was started off with, you know, when it was first capitalized people came on board and they were, "This is good. We like it. Maybe we don't," and now we really do have competition.

We ended up with more money, the banks wanting to put in more money, and there was a competition for it. Literally I was told by a CEO quite recently of a very, very, very large bank the next time we want to be the lead.

Another thing that we partner very, very closely with is our local two CDFIs. Around some of the financial literacy that we do, you know, I work on high-cost loans, Prairie loans (phonetic). I have, you know, over 100 clients, and we work really, really closely. I mean, I think it's impossible now to work on Prairie lending without having a CDFI that I can send them to to say, "Do your credit checks, you know. Refinance. Get cleaned up and refinance," or you know, there's a whole myriad of activities that as a lawyer I cannot do without having a very, very close relationship, and what we've found is we have found that what we can do is essentially fix people's high-cost loan problems using the Progressive Credit Union and other credit unions.

And then finally, you know, again, as I said, we meet with the bank. We meet with the regulators. We send a draft. We send a final letter to the regulators, and this is like a real, you know, quick taking you through very, very quickly what we do, and you know, it's something that I think adds value, frankly, both for the community groups and for the banks, and I think in the exam process and certainly in the merger process.

There is, as I say, a summary of this. The long letter redacted I have a copy of which I can e-mail if folks are interested in seeing. You know, it's a 30, 40-page letter with all the bells and whistles. So thank you for this opportunity.

CHAIRPERSON REITER: Thank you, Ruhi.

MS. MAKER: And I'm happy to answer questions off line when folks have them.

Thank you.

CHAIRPERSON REITER: Ken.

(Applause.)

MR. BORDELON: Thanks.

Can you hear me okay? It's this one, right, Lisa?

Hubert, I've got bad news. I told you this was going to be my 100 secret Cajun recipes. It's Shared Branching in America. I appreciate the opportunity to preen it, and I will try to hurry on and get us back on schedule.

It's called Shared Branching in America. More specifically I'm going to discuss shared branching in our area in Louisiana, which represents four service centers, 51 outlets, 41 credit unions that make up the ownership of the shared branching concept. It's about ten years in the making. We started in 1994.

The asset size of the credit unions that belong to the network range from four million to 454 million in assets. So we do have a wide range of credit unions.

Basically what we do is we join cooperatively credit unions or co-ops and we share service centers, and that allows our members to get service where it's convenient for them.

The concept was formulated because generally credit unions don't have enough members to justify the expense of adding brick and mortar branches everywhere. So when we got together, the basic concept was perhaps we could share our facilities and move forward.

What is a shared service center? This is the Baton Rouge Service Center. It's where the credit unions pool our resources together, and we do own the facility. The credit union only pays for the usage per transaction. So there's no overhead.

There are two types of service centers throughout the U.S. I will discuss the standalone facilities and the outlets. The standalone branch, and this is the lobby at the Baton Rouge Service Center. It's completely owned and operated by the organization. It's not owned by the credit unions. It's a completely neutral environment.

If you'll look in there, there's no marketing allowed. So we don't steal each other's members, and the staff works for the network, the Louisiana Service Center Network and not for the individual credit unions.

An outlet, and this is our Monterey Branch in Baton Rouge; it serves as an outlet. It's an existing credit union branch, to just purchases, the platform, to be able to conduct the transactions for what we call our guest members.

The outlet owners, when we sign a contract with the network, we agree to abide by the national standards and policies, to display the logo, to not solicit guest members, to provide them telephone access, and actually to maintain the branch and maintain a professional image.

You'll notice here one of the main advantages is that our transactions are on line real time. Not always. Everybody knows that's not true. We do have some off-line rules that come into place pretty much. Only $200 are allowed, withdrawals, type of thing; pretty much follow the ATM network pattern.

And we do have a distinctive logo. When you see the swirl, you know that you are at a credit union service center, and I'll get to that later. This is important because we do have a lot of members who travel, and they know where to look for some service.

The services that are available, basically, you know, the basic transactions. We can't do loans yet. We are working on trying to get at least loans closed for our guest members, but mostly deposits, withdrawals. And what was really surprising is when we started this back ten years ago we thought naturally withdrawals, you know. Basically we're going to be the big transaction use.

Seventy-one percent of our transactions last year were in the form of deposits, and that did surprise us.

Naturally the benefits for the credit unions is that we can offer greater convenience to our members, and for some credit unions, they have postponed or just eliminated the need to add the branches at places where our locations -- where they didn't have enough members to justify.

Another side benefit, sometimes when you get into a project, you don't realize all of the side benefits that may accrue, and disaster recovery proved to be a really good side benefit. I could quote Excel Credit Union that was located in the World Trade Towers. After that disaster, they got with the New York Credit Union League and were up and running through their hot site and so forth; had accessibility for their members throughout the shared branching network, which really helped them considerably.

Down home in Louisiana after 9/11, security got real tight on all of our chemical and oil industry down there, where the employees had access to the credit unions, but the dependents did not. Again, the service center concept really bailed out a lot of credit unions there.

And even for credit units with hot site capability, disaster recovery capability here, to have access to basic services is a real benefit.

We offer benefits naturally to existing members, members who travel. We have a lot of Delta employees, credit union employees, members that use our Baton Rouge facilities because they travel a lot.

The members' benefits, you know the words. I mean, members want convenience. Another benefit, of course, is the convenient hours and locations. The main service centers -- and we do have four totally-owned service centers in Louisiana. There's one in

Baton Rouge. There's two in New Orleans, and one in Shreveport, and they're opened until seven at night and on Saturdays, and that's the convenient hours. And the no surcharge ATM is very well received by the members.

Of course, nothing can work without a switch. This is basically the concept of an ATM switch, and the switch basically routes the transaction between the service center outlets and the host credit unions.

The transaction flow is that basically from the service centers or outlets, from the switch, again, basically serving as an ATM switch to the member credit unions.

For the members to access their accounts, they need to know first which credit union they belong to, the name and their account number, and basically the credit unions are routed through an ISO number concept. They have to have valid photo ID to access their accounts.

The transaction flow basically is an example here. The member goes to a credit union outlet. It is verified that he is a member. That transaction is routed through the switch back to his home credit union, verifies that he is, indeed, a valid member and that's a valid transaction; back from the switch to the outlet, and the member receives his cash and goes on his way.

The settlement flow of that just follows the transaction. Credit unions belong to a corporate network through U.S. Central Credit Union, and the funds basically follow the transaction, and that's just an example of a deposit. For over a $100 deposit, the switch generates the settlement file through the central to the corporate, and it hits the account at the credit union and the correspondent account at the service center. Then the corporate account for the credit union is debited, and the member's account is credited for the $100 deposit.

For the service center or the outlet, the transactions hit their vault cash in the corporate account.

There are naturally income expenses. I think most of the expenses dealing with shared branching concept are software and communications expenses. For us who are outlet owners, there's also income to be derived from this.

A basic transaction cost occurs at about $2. An outlet owner earns about $1.50. When we first started this a lot of credit unions said $2 a transaction seems high, and when you evaluate the cost of building a branch, $2 is a bargain.

The typical expenses naturally.

This is our Sherwood facility where we do receive income from those transactions. What's not known there is we do allow guest members to have access to their accounts through the drive-up. Those rules vary by credit union, but it's very well appreciated by the guest members.

Like I said, the software and com. costs are pretty much most of the outlet owner's expense. There's some up front costs to buy the software, and that's pretty much a repeat of that.

This is just a testimonial from one of the CEOs. Wymar is BASF Y and Dot (phonetic) down on the river, and they're pretty much isolated and even more so after the increased security, and that's just a testimonial to say that the shared branching concept has helped his credit union grow.

And, again, that's our symbol, and we use the symbol in all of our marketing, and for those members who are aware of it, they look for the swirl first, and that helps our marketing. They know what to look for. We use it on our signage. This is a Baton Rouge Telco Federal Credit Union, just opened a brand new branch, and they chose, you can see, to display prominently their service center logos.

We do have strict internal controls. We are audited by an independent auditor and by network staff. Cash is under dual control, and we follow a secret shopper program to make sure that not only we're in compliance with all of the rules and so forth, but we have a good quality of service.

I don't know here, but we earned an exceptional secret shopper program award.

The growth so far, as you can see, we almost doubled the 55 institutions in the last five years. We completed 1.3 million transactions in '02. That has kind of leveled off now as the number of outlets have kind of slowed down.

We are in third in the United States. In the U.S, there's just that middle section there. Earl, I don't know what's wrong with that section. They must have commercial banks.

I think the number now is over 1,100 service centers throughout the U.S., and we are actually in other parts of the world, in Guam, Italy, Japan, Korea, and Puerto Rico.

And in summary, it just provides a very valuable asset for the credit unions, and it does give them a high touch contact point for our members and actually increased convenience.

And I appreciate your interest. Thanks.

CHAIRPERSON REITER: Thank you, Ken.

(Applause.)

CHAIRPERSON REITER: I'd like to turn to the committee chairs for an expedited, not to exceed three-minute summary of some of the issues that were discussed yesterday that did not get discussed today, and also for a very brief indication of the matters that will be taken up in future meetings.

And if I could start with Buzz for your committee.

MR. ROBERTS: Sure. The Compliance and Community Reinvestment Committee met yesterday, and we spent our time talking about two items. The new market tax credit was the first. This is a new tax credit authorized in 2000, but it's just rolling out now.

We heard from Matt Josephs, the acting program manager for the program at the Community Development Financial Institutions Fund, as well as from Dan Letendre (phonetic), Vice President from J.P. Morgan-Chase, which is actively looking at investing in return for new markets credits.

It was a very good discussion. I think what we discovered is that this is really still a work in progress and very much at the beginning of the reality of this. Right now the first round of awardees who have these credits to market at just signing their operating agreements with the Treasury Department, and so they are just now hitting the investment market.

And Dan's comments were very interesting in terms of how a potential bank investor would regard these.

The second discussion we had was also based on a presentation here from Bob Avery of the Fed. staff on research on the impact of the Community Investment Act, starting to look at Census data from 2000 and comparing it with 1990 data, and trying to define outcomes and looking at certain neighborhoods just above and below the thresholds of CRA applicability.

So far the results have shown discernable, but very, very modest results in neighborhoods just under the 80 percent threshold of area median income compared with those just over the 80 percent threshold, and we had a nice, I thought, discussion of sort of what that meant and whether those were the right places to look and how you could look at other places, too, and what the dynamics were.

So I think there's a lot more interesting research to be done there.

We did not really pursue the regulatory compliance burden reduction discussion that we had done and had begun earlier in other meetings, but we pledged to return to it. We're really going to miss you, Anthony, on that discussion, but Susan seems to be ready to take over the baton, and so we started to make a little bit of progress, I think, and we want to just stick with that.

CHAIRPERSON REITER: Thanks very much, Buzz.

Earl.

MR. JAROLIMEK: Thanks, Ron.

The Community Affairs and Housing Subcommittee talked about in addition to our topic today regulatory, civil, and criminal enforcement actions for predatory lending. This was kind of the last chapter in a series of predatory lending presentations.

We heard from Bob Cook from the Fed. staff who had a terrific presentation. He took us through subjects including current adequacy of enforcement, other options, and is new legislation necessary?

It was a very good discussion afterwards. I'm not sure we reached any conclusion other than to say that it's a worthy topic for further discussion, and it will be included in the next topic list.

The other topic we took up was earned income tax credit programs and mainly the discussion centered around the benefits, including banking the unbanked, financial literacy, income tax preparation services, investment incentives, et cetera. So that was the topics we covered yesterday.

For the next meeting, as I said, more discussion on discussion of predatory lending, including some of the OCC's rules that have been issued with regard to that, to help stimulate further discussion.

Also want to talk about HMDA data collection. How are the new rules impacting financial institutions? That would be a timely subject for March as financial institutions report under the new rules starting in 2004.

And also a follow-up on the funding of nonprofits, which was our topic that we discussed today to kind of expand the scope, maybe explore greater the role of government funding and corporate funding and talk about models that have worked.

So that was our topic list.

CHAIRPERSON REITER: Thanks very much, Earl.

And, Earl, while you have the floor, since this will also be your last meeting, if you'd like to have a 30-second valedictory.

MR. JAROLIMEK: Well, I, too, want to just recognize and acknowledge the other members. And I said to someone this morning I think we've all learned a lot from each other, and I can say that's certainly true for me. It has been a very rewarding experience.

I have had a privilege in serving and want to thank all of the members and the Fed. staff. They do a terrific job, very organized, keep this week very -- you know, it's hard to keep all of us in line, but they do a wonderful job.

I would have a lot of comments that would be in the context of what Anthony said, but I want to recognize Governor Bies' comments that there are opportunities for comment on the regulatory burden reduction, and you know, in my several years in compliance I've seen this topic come up before. I hope this is a meaningful endeavor that the agencies are taking on, and I think this is probably the best organized approach I have seen.

So I'm hopeful that's true, and I will comment, yes. Thanks for the invitation.

CHAIRPERSON REITER: Thank you, Earl.

Pat.

MS. McCOY: Yes. On Consumer Credit yesterday, in addition to convenience checks, we had a long discussion of TILA disclosures for variable rate home-secured loans, and part of the discussion focused on a proposed set of new disclosure forms that Elizabeth Renuart has developed.

And as we looked at the forms, for the most part the committee members felt that they were workable, might be a good idea, and part of our discussion was then should these forms supplant other disclosures or be in addition to them.

I believe Board staff will be looking at this issue in months or years to come, and will probably be returning to this once staff takes a look.

Our last topic yesterday was an update on three recent federal appeals court decisions on aspects of the Truth in Lending Act, and we discussed concerns raised by these decisions, and the Board now is taking the matters under advisement with the staff.

For next time we'll be looking at debt cancellation and suspension agreements and their regulatory treatment. Assuming that amendments to the Fair Credit Reporting Act are enacted, which I think is highly likely, we'll be returning to that topic, as well as any new identity theft legislation that comes out of Congress this year.

And if we have time, we will be looking at the TILA treatment of discounted loans.

So that's it.

CHAIRPERSON REITER: Thank you, Pat.

Oscar.

MR. MARQUIS: Thank you.

The Depository and Delivery Systems Subcommittees talked only about payroll cards, which we repeated this morning to a certain extent. It was very lively, led off by Dan Lonergan, who did a great presentation of the background issues for us from the staff.

And then we had an outside speaker, Mark McCarthy, of Visa USA which issues one of those cards, and as I said, we repeated some of that discussion this morning.

For next year we've selected a number of topics. The OFAC regulations and any interpretation opportunities for the Fed under those regulations.

The check truncation issue; the E-sign Act and the status of the regulations under that act; business accounts; and deposit insurance reform.

CHAIRPERSON REITER: Thanks very much Oscar.

Well, we are close to adjournment. Before we do adjourn, I wanted to mention, of course, that there will be lunch served for the Council members in Dining Room L just down the hall to the left after we're finished.

I just wanted to express once again my deep appreciation for my ability to participate in the Council. This has been a remarkable experience. There have been a great deal of different viewpoints expressed, but they've always been expressed in the great atmosphere of collegiality, and while we may not have always reached consensus or we may never have reached consensus, nonetheless a number of viewpoints have been vetted, and they've all been done, I think, with good spirit and with respect for all the members and the viewpoints of all the members.

We can't thank enough the support of the staff and certainly all members of the staff. I see Adrienne Hurt there, and she deserves special mention. Her contribution to the work of the Federal Reserve over many years is astounding, and I think we all have been enriched by it.

That's not to disparage any of the other people here. We have excellent members of the staff who have done a wonderful job.

And again, thank you very much for allowing me to participate.

We are adjourned.

(Whereupon, at 12:59 p.m., the meeting was concluded.)