Peoples
STATE BANK
Financial Advantage For Your Lifetime

March 27, 2008

Mr. Scott Cattanach
Chief Financial Officer and Senior Vice President
Peoples State Bank
1905 W. Stewart Ave, P.O. Box 1686
Wausau, WI 54402-1686

Ms. Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551

Re: Docket No. R-1305 proposal published in the January 9, 2008 Federal Register

Dear Ms. Johnson:

We are writing concerning our comments on the proposed regulation identified in Docket No. R-1305.

Peoples State Bank located in Wausau, Wisconsin is a $520 million total assets commercial bank with an emphasis on local residential mortgage lending on homes located within our local market area of central and northern Wisconsin. We originate loans for sale to the traditional secondary market as well as fixed rate 1st mortgage residential "balloon maturity" loans. Peoples has never engaged in sub-prime lending, but has engaged in traditional mortgage lending for local residents since 1962. We are very concerned about helping our customers to make good financial decisions regarding their home purchase and financing. This is reflected in Peoples' average net loan charge-offs of residential mortgage loan principal during the three years ended December 31, 2007 of just .03% per year. Peoples is the 2nd largest residential mortgage originator in the Wausau-Marathon County MSA.

<u>We are concerned about the Federal Reserve's proposed definition of a "higher priced mortgage loan</u>." The proposed definition with its APR spreads of 3% and 5% over equivalent Treasury rates would capture a large majority of our balloon mortgage business which we retain on our balance sheet rather than selling to the secondary market. Most of our balloon mortgages carry a fixed rate for three years followed by a balloon payment. Most customers upon maturity roll the balloon payment into the same mortgage product for another three years.

Despite our encouragement to customers to take advantage of the lowest possible rates available through secondary market programs, there are many reasons why local customers choose a balloon maturity mortgage retained on the books of Peoples State Bank rather than entering a secondary market program. Some of these include:

- The customer residence is located outside of a metro area making comparable sales for an appraisal difficult to obtain, negatively impacting participation in a secondary market loan program.

- Some properties with high values relative to the level of mortgage debt may avoid the appraisal cost by reference to the municipal assessed value for real estate tax purposes in lieu of an appraisal, precluding participation in the secondary market.

- Lower closing costs or streamlined underwriting may be available for borrowers or homes with special credit or valuation situations if the loan is retained in-house.

- The customer may desire to avoid required monthly escrow payments for taxes and insurance associated with a secondary market loan.

- The customer may desire to retain mortgage loan servicing with Peoples State Bank so that they may call local bank staff directly to get problems or questions resolved.

- The customer may desire to obtain a mortgage loan without the requisite job history or if credit blemishes on their credit record from special situations prevent them from obtaining a secondary market loan.

One of the reasons some customers choose our balloon mortgage is avoidance of maintaining tax and insurance escrow accounts. The proposed rules would require establishment of escrow accounts on what would be referred to as higher priced mortgage loans, significantly increasing bank cost and customer frustration for no regulatory benefit. Due to our knowledge of the local customer base and existing risk management systems, Peoples is very comfortable retaining in-house mortgages without escrow requirements. Avoiding internal systems to open, track, and submit payments related to escrow accounts helps to keep bank operating costs low, benefiting both customers and shareholders.

Application of the proposed spreads over Treasury securities in today's market characterizes virtually our entire retained in house mortgage portfolio as "higher priced mortgages". For example, as of March 21, 2008, our 3 year "in house" balloon mortgage posted an APR of 6.52% at the same time a 3 year Treasury security yields 1.79%. This spread of 4.73% is much higher than the 3.00% spread proposed by the regulation. ***Even our conforming secondary market posted 3 year fixed FNMA ARM rate of 6.19% would be defined as a higher priced mortgage.*** In addition, our long-term secondary market posted rates such as a 15 year fixed rate (fully amortizing) of 5.44% is just .15% inside the cutoff for a higher priced mortgage. Our posted secondary market rates generate a commission paid to the bank of approximately 1%, well within normal industry practice.

As a small bank, we do not have the resources to submit significant data to support a different spread or matching Treasury security methodology to the Board. However, we do understand that the current definition captures a significant majority of prime rated residential mortgages and subjects the bank and these customers to extensive and costly new regulation. This is caused in part from market conditions that have created a situation in which Treasury rates are falling much faster than wholesale funding rates, greatly increasing the spread on mortgage related products.

We suggest to you that the Board of Governors' goal of reaching subprime mortgages while excluding prime mortgages could be accomplished by using a reference rate other than the U.S. Treasury security. For example, loan pricing from originations packaged as GNMA securities could provide a "par value" reference rate for conforming loans. A spread could be added to the par value reference rate to determine a target for defining a higher priced mortgage.

For example, if GNMA is packaging conforming residential 30 year fixed rate mortgages at 5.25% at par, a reduced index of 2.00% (rather than 3.00% as proposed) could be added to this reference rate to arrive at a regulatory APR trigger of 7.25% for closed end 1st mortgages. This compares to a trigger of 6.33% based on 3.00% over the 10 year Treasury rate as currently proposed by the Board. Using a reference rate that is directly relevant to prime quality mortgages rates (such as those issued by public agencies and packaged by GNMA) is clearly a good reference on which to determine a target for a "higher priced mortgage" as intended by the proposed regulations.

The proposed regulations would redefine many community bank in house mortgage portfolios as "high priced mortgages" simply because credit spreads relative between Treasury securities and mortgage related assets have increased. **We ask the Board of Governors to re-examine the best way to identify customers who need additional protection from higher priced mortgages without punishing the very banks which have always dealt fairly with their residential mortgage customers.**

Sincerely,

Scott M. Cattanach

Scott M. Cattanach
Chief Financial Officer
Peoples State Bank

cc: Mr. Peter Knitt, President, Peoples State Bank
cc: Mr. John Proulx, Senior Vice-President of Retail Services, Peoples State Bank