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April 7, 2008

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Ms. Johnson:

Re: Docket No. R-1305

Thank you for affording us this opportunity to comment on the proposed Home Ownership and Equity Protection Act amendments to Regulation Z which you currently have under consideration.

Bank of Yazoo City (the "Bank") is a community bank with $214 million in assets. As such, we are closely and cautiously regulated by our federal and state banking regulators.

It is our strongly felt conviction that the regulated banking industry, and community banks such as ours in particular, played virtually no part in creating the current mortgage predicament which faces customers, creditors and regulators alike.

IN GENERAL

Community banks have long sought to meet the needs of their communities and customers while trying to comply with numerous regulations, including the Community Reinvestment Act (CRA) and Regulation BB. Of course, a primary focus of CRA is upon those low to moderate income customers who appear to be the persons most affected by the current mortgage loan crisis.

A significant factor that sets commercial banks apart from other creditors is their unique ability to know and work with each of their customers. Community banks, almost without exception, see low to moderate income customers as an opportunity to fulfill the bank's mission to its community, while bettering the lives of individuals who may be friends, neighbors and, perhaps even, family members. That is a very different situation from many of the large scale mortgage lenders that have mass-marketed mortgage loan products and quickly securitized those loans to reduce their exposure to borrowers they barely know.

While community banks seek to meet their CRA obligations to the communities that they serve, they must do so in compliance with the Equal Credit Opportunity Act and Regulation B. Every commercial bank is conscious daily of the need to avoid discrimination of all types when considering applications from all customers. That concern manifests itself in a conscious effort

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to look at each applicant's individual situation when deciding whether to extend credit, how to condition an extension of credit, how to price credit, *etc.*

In general, community banks do not think of themselves as "subprime lenders", as that label is applied to many of the mortgage lenders that have contributed to the current situation, many of whom no longer exist. At the same time, many community banks, especially those with a presence in smaller towns or rural areas, have numerous customers who fit the description of a subprime borrower if viewed from any of a number of characteristics, *e.g.*, credit score, income, debt-to-income ratio, *etc.*

And yet, community banks have found it necessary, and even profitable, to extend credit to these customers. To do so, community banks have had to be creative in both their underwriting practices and the pricing of these loans.

I am confident that almost all community banks will find themselves impacted by the regulation changes currently proposed due to the fact that they have extended needed credit to customers they know well, but who have subprime credit characteristics which require risk-based pricing that places those loans into the category of first or second lien loans that have rate spreads in excess of the proposed thresholds, so-called "higher-priced" mortgages.

Community banks have previously had to endure the hardships of regulatory burdens due to situations for which they were not responsible. During the Savings and Loan Crisis of the 1980s, community banks were faced with regulatory changes that were quite burdensome, while at the same time in many cases, purchased the fallen institutions and certainly serviced the customers suffering through the crisis in many ways. It is our concern that to the extent the proposed regulatory changes become so burdensome that community banks find it difficult to comply, there will be an adverse affect on the availability and cost of credit to the very class of borrowers that the regulatory changes seek to protect.

The following comments should be viewed with the aforesaid background for community banks in mind.

HIGHER-PRICED MORTGAGES

With respect to "higher-priced mortgage loans," the proposed regulations do four things:

1. prohibit making these loans based on collateral alone and with no regard for the customer's ability to repay;
2. require a creditor to verify a customer's income and assets using third party documentation;
3. require the establishment of escrows for taxes and insurance; and
4. prohibit prepayment penalties under certain conditions.

As mentioned above, community banks go to considerable lengths to assess whether a particular loan is appropriate for a particular customer. Collateral-based lending with respect to consumer mortgage loans rarely, if ever, occurs at a community bank. At the same time, community banks are in a better position to be familiar with their customers, their employment characteristics and history and especially their demonstrated willingness and ability to repay the

bank that has accommodated them with loans in the past. Requiring these community banks to document, more so than they presently do, a customer's income, assets, *etc.*, may well make the process so burdensome and expensive as to force community banks to stop working with some customers as they have done in the past. The result would be less credit availability for customers that fall into the "high-priced" range of rate spreads and less profitability for banks. CRA results would also suffer. One possible solution would be to eliminate the verification requirement for subordinate-lien loans.

The requirement to establish escrow accounts for first-lien "higher-priced mortgage loans" is an acute problem. Because these loans occur at community banks as a result of the bank seeking to work with all of its customers, one loan to a customer that exhibits subprime characteristics will be subject to this requirement, but the next loan to a more creditworthy applicant will not.

Community banks that hold these loans in their own loan portfolio, as opposed to selling them in the secondary market, lack the ability in most cases to maintain escrow accounts at all, much less on a case-by-case basis. To require community banks to do so would cause extraordinary time and expense to purchase additional software and computer systems and to hire additional staff. That expense would quickly find its way into the pricing of loans and the addition of fees. Conceivably, community banks would find themselves driven to avoid those loans that trigger the escrow requirement, thereby denying credit to those customers the regulations seek to protect. The escrow requirement should be eliminated and a simple requirement that taxes and insurance payments be factored into the underwriting requirements and early disclosure requirements should be substituted.

On the subject of prepayment penalties, the Board should restrict the prohibition of those charges to those loan products that have demonstrated the most potential for harm. As presently proposed, this portion of the regulations would apply to all closed-end mortgage loans that have a rate spread in excess of the range declared for "high priced" loans. The requirement should be limited only to true subprime loans with an adjustable rate feature that could trigger a need to refinance in times of rising interest rates.

CLOSED-END CREDIT

Other proposed measures apply to closed-end credit secured by a customer's principal dwelling. These provisions will impact virtually every closed-end extension of credit that a commercial bank makes secured by a customer's dwelling.

The first measure deals with the payment of yield spread premiums to brokers. Many community banks do not utilize brokers to locate or originate mortgage loans; but to the extent that one does, the requirement to review, approve, *etc.*, the agreement drafted by a broker and signed by the customer will add both expense and delay to the loan origination process. Although the impact of this change is not clear at the present, such a change could result in a reduction of credit availability or an increase in the cost of credit when available.

The portion of the proposed change in regulation that deals with the calculation of the amount of yield spread premium that a broker may receive setting a predetermined amount that a broker may receive through the mechanism of a yield spread, and doing so at the time of

application and before any loan underwriting has taken place, may result in confusion among lenders, brokers and borrowers alike. It seems possible, and perhaps likely, that such a limitation could have unintended consequences for both lenders and borrowers.

A second change would prohibit creditors from extending credit when they know, or have reason to know, that someone has coerced an appraiser into misstating the value of a customer's residence, although with "reasonable diligence" a creditor might be able to determine that the misstated value was not material. This provision is particularly unnecessary for commercial banks, and community banks in particular. The banking industry for more than a decade has operated within guidelines established jointly by the various federal bank regulatory agencies aimed at ensuring the integrity of the appraisal process. To subject the appraisal process for regulated banks to another level of regulation and inquiry would add a confusing and unnecessary complexity to the loan approval process. When does a lender "have reason to know," and just when does a misstatement of value become "material"?

The part of the proposal which deals with mortgage loan servicing seems particularly inappropriate when applied to community banks. The proposal seems to anticipate that all servicing rights (and obligations) are sold or passed along. In the explanatory material which accompanied the proposed regulatory changes, you made the statement that, "servicers do not compete in any direct sense for consumers." That statement is simply inaccurate in the case of many community banks. Community banks retain a substantial portion of the short term closed-end loans secured by a customer's dwellings that they originate. To assume that those banks are not competing with other banks when it comes to meeting the needs and requests of their customers is simply wrong. Community banks must strive to meet the needs and requests of all of their customers in connection with all of the loans they make.

One part of the proposal would prohibit a late fee from being charged as a result of a portion of a regular payment being used to pay an earlier late charge (so-called "pyramiding"). Many state laws already restrict this practice and, while redundant, an additional prohibition would not unduly burden community banks.

Much the same comments as above would be true for the portions of the proposal which require a servicer to provide a list of specific fees and charges and an accurate pay-off statement. While perhaps unnecessary in the case of community banks that service their own loans, the fact that the list of fees and the pay-off statement only need to be furnished within a "reasonable" time (generally three business days) makes these provisions workable.

Finally, the proposal lists a number of advertising practices that would be prohibited. Most community banks do not engage in the type of advertising listed in the proposal; therefore, there should be little or no objection to the prohibition of these advertising practices. However, the prohibitions intentionally did not extend the advertising prohibitions to open-end home equity line of credit (HELOC) products using the rationale that the perceived advertising abuses had not been noted in connection with HELOCs.

Many community banks offer open-end HELOCs and would strongly support the Board's decision not to burden those products with unnecessary advertising restrictions. Since most of the suggested disclosures are already being given by lenders in connection with revolving HELOCs, there should be no reason to further regulate the format for advertisements of these products.

EARLY DISCLOSURES

Finally, the proposed changes in regulation revise the current rule to require creditors to provide early good faith estimate disclosures to customers in connection with the non-purchase money closed-end mortgage transactions, in addition to the current requirement for such disclosures in purchase money loans. No fee could be charged before these disclosures are given, with the exception of a bona fide credit report fee.

For most community banks, purchase money mortgage loans are the exception rather than the rule. However, community banks have successfully complied with the early disclosure of good faith estimates of closing costs for years and will be able to do so for non-purchase money loans. However, the burden of ensuring compliance with these early disclosures as part of TILA compliance would add to the cost of non-purchase money loans and could add delay to the credit approval process. Increased cost and delay may work to the detriment of customers. The possible value of assisting a borrower in shopping for loan terms for what in some cases may be small loan amounts should be weighed against the increased compliance burden to banks.

CONCLUSION

In conclusion, we urge the Board to take into consideration the significant impact that the proposed changes in regulation would have on the many community banks throughout the country. In large measure, those banks have not engaged in the practices which have led to the current problems within the mortgage industry. With few exceptions, the additional regulatory burdens placed upon community banks will prove to be counter productive if the net effect is a reduction in credit availability or an increase in cost of credit for the customers that the regulation seeks to protect. We urge the Board to focus, where possible, on the products and the players that have had the greatest impact on the current mortgage "crisis."

Thank you for this opportunity to comment.

Very truly yours,

Bank of Yazoo City

S. Griffin Norquist, Jr.
President and CEO