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February 27, 2008

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

Dear Ms. Johnson,

Thank you for the opportunity to comment on Docket No. R-1305 (Higher-Cost Mortgages). We are an $800 million mutual institution with nearly 70% of our loans classified as residential real estate. We sell some production to Freddie Mac and retain the remainder in our own portfolio. Like most community banks, we chose not to offer the risky and irresponsible lending products that contributed to the "mortgage crisis". In that spirit we are very concerned about proposals like this that ladle more regulation on top of an already crushing burden. This burden has made mortgage lending (and banking itself) increasingly unattractive to community banks, the very institutions that can help consumers the most. Rather than go point-by-point through the proposal, I've focused on the definition of "Higher-Priced" mortgage loans and Coercion of Appraisers as it relates to mortgage brokers and mortgage bankers.

The Higher-Priced Definition Goes Too Far

We are concerned about meeting an overly broad "ability to repay standard". Setting the threshold to include prime loans puts us at additional risk for litigation when a soundly underwritten loan goes bad for reasons beyond our control.

Current bond market conditions have demonstrated how inadequate a 3% over Treasuries bar is. That will capture several of our market-priced adjustable rate products as well as a nonconforming 30-year fixed rate mortgage of 7% (with no points). Seven percent hardly seems "higher-priced". We offer that option to customers uncomfortable with ARM's who don't qualify on the secondary market. We will discontinue the product rather than lower the rate or allow ourselves the stigma of offering "higher-priced mortgages". Additionally, the proposed definition may capture investment grade loans due to new delivery fees required by Fannie Mae and Freddie Mac. The rate bar is set too low.

At a minimum, the Board should rely on the HOEPA standard. That will reduce regulatory burden by having one threshold to contend with and lessen the likelihood of prime loans being included due to bond market volatility.

The Appraisal Coercion Proposal Is Easily Circumvented

This portion of the proposal is well intended, but will have little practical effect. Participants with no "skin in the game", such as lightly-regulated mortgage brokers and mortgage bankers, are largely responsible for much of the "mortgage crisis". In New Hampshire, they are responsible for originating nearly all the loans in foreclosure. Abuse of the appraisal process has been widespread.

The Board proposes to reign in inflated appraisals by prohibiting "coercion" of appraisers. Unfortunately, the Board's proposal is too vague and easily circumvented.

Coercion can be overt. As a former member of the NH State Appraisal Board, I saw some cases of overt coercion by mortgage bankers. Usually, this would entail writing the "required value" on the appraisal order. That's fairly easy to police.

However, most abusive appraisal practices are more subtle. Originators with no skin in the game simply order appraisals from those that are fastest, cheapest, and don't "screw up the deal". There is no business reason for them to do otherwise. A veteran appraiser shared a story with me from two months ago. He was being interviewed by a mortgage broker office in West Central New Hampshire, 60 miles from the nearest MSA. According to the appraiser, the broker would give him all their business for turnaround time of half what he could normally deliver and if he didn't check off "Rural" to describe the market. In other words, quality didn't matter. It's plainly evident that appraisers who won't "play ball" with mortgage brokers simply don't get the work. These practices harm consumers but will never be stopped by the Board's current proposal. The Board should go further.

A more effective proposal would prohibit federally-regulated lenders from funding or purchasing loans with appraisals ordered by institutions not federally regulated. The OTS prohibits my salaried mortgage lenders from ordering appraisals even if we're holding the paper. However, a commissioned mortgage broker can order appraisals all day long. That makes no sense.

Finally, the Board should re-examine the regulation of mortgage bankers and brokers. States have demonstrated they are either unwilling or unable to effectively police and regulate these groups. Their failure to do so has been harmful to consumers and our economy. A strong, national regulator of non-bank lenders should be part of the discussion.