SOUTHSIDE BANK

P.O. BOX 1079, SOUTH BECKHAM AT EAST LAKE, TYLER, TEXAS 75710-1079 903/531-7111 Fax: 903/592-3692

October 24, 2008

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Mr. Feldman:

Re: Risk Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Framework; Proposed Rule

Southside Bank was chartered in 1960 and is a state non-member bank. Southside Bank is owned 100% by a one-bank holding company, Southside Bancshares, Inc. At year-end, total assets were approximately $2.1 billion.

We are a non-complex bank and believe that we have taken measures to ensure strong underwriting resulting in sound risk management. We would welcome the opportunity to benefit from these practices, but most likely will not under this proposal. We have a proven history of a low percentage of charge offs and consistent monitoring to know when and if adjustments need to be made in the underwriting process. We believe that our credit culture is such that we can justify lower capital requirements based on our internal processes. Even during today's volatile economy, we have remained strong. This is due in large part to our underwriting process. This proposal does not give any credit to these sound underwriting practices.

We would like to again touch on three components mentioned in the proposal.

<u>External Ratings:</u> As we have stated in previous letters, we do not see any benefits for most non-Basel II banks resulting from the use of external ratings for borrowers. External ratings are not available for the typical non-Basel II bank's borrowers. You are completely ignoring the adequacy of a bank's own underwriting ratings. Given the question of creditability with the external ratings today, this cannot be a better indicator of risk than a bank's own underwriting standards. We have a thorough understanding of our borrowers and their risk through analysis of our borrowers' history, financial statements, peer analysis, management analysis, local economy, and components of each loan's structure. It is unfair to require more capital than a rated borrower just because they have a rating.

<u>Public Sector Entities:</u> We do not believe that the proposed external ratings treatment should be extended to public sector entities. We believe that the current method is risk sensitive and appropriate. It would be cost prohibitive to most of the public sector entities in our lending area

to obtain an external credit rating and that does not make them more risky than one who is rated. This type of loan makes up approximately 10% of our portfolio. Our underwriting process on these loans includes financial statement analysis, taxpayer analysis, and consideration of its location and local economics. The majority of these loans also have tax pledges. To say that our loan to a non-rated municipality with our thorough underwriting and a tax pledge carries more risk than a AA rating entity just because they have not paid for a rating is not a prudent way of determining true risk to capital when in fact our municipality may be less risky than the rated one.

1-4 Family Residential Property: In light of the mortgage industry's problems today, we believe that a more prudent risk assessment is in measures such as credit scores and debt-to-income ratios. Credit scores indicate propensity to pay and debt-to-income indicates capacity to pay. The risk of a loan defaulting is in repayment. The collateral and its value are only sources of recovery once a loan has defaulted and in no way determines whether or not a borrower can make his monthly payment. The amount of your recovery is dependent upon value of the property and in many markets today's real estate values are not stable enough to be the sole factor in setting your capital standards. LTV is not an adequate stand-alone indicator.

You can have two loans with both of them having an 80% LTV but one having a 500 credit score and a DTI of 45% and the other having a 750 credit score and a 25% DTI. Your first loan has a far higher probability of default than the second loan but they have the same LTV.

It is not clear as to size and quantity of banks this proposal is intended to apply to. We feel that the proposal is inadequate to properly modify the capital standards on the mid size community bank level. We appreciate the opportunity to comment on the proposed revisions to the Capital Accord and anticipate other methods of measuring risk based capital for banks our size will be considered in further discussions.

Sincerely,

Jeryl W. Story
Senior Executive Vice President – Senior Lender

Anne Martinez

Anne P. Martinez
Vice President
Loan Review Officer