

October 22, 2012

Ladies and Gentlemen:

RE: Basel III Capital Proposals

On behalf of First State Community Bank, I want to thank you for the opportunity to comment on the Basel III proposals that have been released for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The financial crisis of 2008/2009 indicated the need to have strong capital standards, which Basel III is attempting to address. Unfortunately, these new big bank standards will have a grave impact on community banks if they are passed as proposed. It is certainly very disappointing to see community banks being so severely penalized by the regulatory agencies for something they had nothing to do with.

To give you a little background on First State Community Bank, we are a \$1.3 billion financial institution located in Southeast Missouri. We have 34 locations from Hayti in the Bootheel of Missouri all the way to Columbia in the heart of the state. Our banks serve a diverse set of commercial customers from farmers to manufacturers as well as a diverse set of consumers that live in both rural and metro areas. All of these different groups require tailored loan structures with considerable flexibility which we have always been able to provide in a safe and secure manner. Our growth has come from a combination of acquisitions and de novo branching in locations where we have found high quality local bankers to serve the needs of the community.

Our first area of concern, as it relates to the new capital standards, pertains to the proposed phase out Trust Preferred Securities. It is our position that Trust Preferred Securities should be grandfathered for institutions between \$500 million and \$15 billion in total assets, as consistent with the Collins amendment. Currently our bank has \$10,000,000.00 in Trust Preferred Securities outstanding with a maturity date of September 2036. Within the framework of the current proposal we must phase out these securities from Tier 1 Capital by 2023, which is thirteen years prior to the original maturity. In today's environment, access to capital for a privately-held community bank is greatly reduced and very challenging. Why eliminate this valuable capital resource years ahead of maturity? At First State Community Bank, we utilized this capital resource sparingly, as did many other community banks, and now, as proposed by Basel III, we would be severely penalized. Our bank utilized Trust Preferred Securities, as allowed by the existing regulations, and now your agencies are proposing that the regulations be changed to our detriment! For First State Community Bank this equates to \$100,000,000.00 to \$120,000,000.00 in loans that we will no longer be able to extend to borrowers or worse yet, we could be required to send these borrowers looking for other alternatives in order to cover our dramatically reduced capital and lending ability. Looking across the State of Missouri, this will have the effect of taking many billions of

dollars of loan capacity out of the local banking system. This reduction of lending capacity has the potential to further increase the possibility of another recession in the communities served by community banks, for absolutely no rational reason. Many of these communities are still in recession today and this will only make it worse. If banking regulatory agencies will not abide by the Collins amendment as included in the banking reform act, we would propose that Trust Preferred Securities be phased out proportionally 10 years from the stated maturity of the instruments. In our bank's position, we would start the phase out in 2026. Should the economy improve sufficiently and the ability to raise capital for privately-held community banks become less challenging, we could then possibly retire them at an earlier date.

Our second concern is the inclusion of accumulated other comprehensive income (AOCI) being reported through the bank's capital account. First State Community Bank is fortunate in that we have a higher loan to deposit ratio than many community banks, and our reliance on our investment portfolio for income is not as significant as some banks with lesser loan to deposit ratios. Our bank has a conservative investment portfolio with a 2 to 3 year duration, but if rates increase by as much as 300 basis points, the effect on our bank could be a reduction of capital of around \$13,000,000.00. While this would not actually change our bank's equity, our capital ratios from a regulatory perspective would be dramatically altered. We would be required to reduce the availability of credit to our small businesses and consumers. Should the above scenario present itself, our bank would find it necessary to reduce the loans on our balance sheet by approximately \$130,000,000.00. This loan portfolio reduction would have a very significant economic impact on the communities we serve. Most of our branches are in small communities and in many cases we are the primary lender in the market. Most of these smaller markets lending needs are served only by community banks and this could be a devastating hit to local economies. We believe this section of the Basel III proposal creates extreme and unnecessary volatility in the equity of community banks.

The final issue I would like to comment on is the new risk weightings. It appears that there has been a major emphasis on restricting residential real estate lending, particularly balloon notes, adjustable rate notes and second mortgage lending. For us as a community bank, all three of these products are vital to both the communities we serve, and the profitability of our bank. We do not have the capability to hedge our portfolio, or obtain long term fixed rate funding on our balance sheet. Not all real estate borrowers have the need for 25-30 year fixed rate loans. Most of our borrowers do not qualify for secondary market loans, especially in light of the difficult underwriting standards in the current environment. This is of course a common occurrence in smaller communities where few, if any, borrowers ever did qualify for secondary market loans. We accommodate these borrowers very effectively for their particular borrowing needs by offering adjustable rate mortgages or balloon notes, as well as second mortgages. These products have served our customers, many of which are in rural areas, very well for many years. Under the proposed risk weighting we could foresee our reserve allocations on these loans increasing from the current 50% risk weighting to as high as 100% or more. If the Basel III proposal is adopted, we will have to reconsider offering these vital mortgage products to our customers, or require a higher risk premium for the additional capital required.

Either alternative would cause significant damage to the rural real estate markets we serve, as well as to the borrowers who will never be able to secure secondary market financing products.

In order to comply with the proposals of Basel III, our bank will be required to make large investments in computer software, in addition to the human resources required to handle the very complex calculations to maintain the proper capital. Along with meeting these new standards, will be the reduction of lending in the communities we serve. This reduction in lending has already started due to the complex nature of all the new regulations created by the Dodd Frank bill. These additional proposed changes are also occurring at a time when we have witnessed regulatory forces substantially reducing our ability to create fee income. The reductions in both lending and fee income will have the effect of reduced total income while at the same time we are charged with increasing our capital. The lack of ability to create a return on capital greatly increases the challenge our bank will face in our effort to raise additional capital to meet these new standards.

In summary, we realize there is a need to have strong capital standards to help prevent a financial crisis in the future, but we ask that a common sense approach to capital changes be implemented whereby regulators truly understand the effects these changes will bring to the nations community banks. Basel III could detrimentally change the landscape of community banking and the communities we serve. It will, over a relatively short period of time, eliminate community banks in many small communities.

Once again, I thank you for the opportunity to comment on the proposed changes.

Sincerely,

A handwritten signature in black ink that reads "Greg Allen". The signature is written in a cursive, slightly slanted style.

Greg Allen  
Chairman and Chief Executive Officer