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October 22, 2012

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

regs.comments@federalreserve.gov
Subject: "Basel III Docket No. 1442"

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429
comments@FDIC.gov
Subject: "Basel III FDIC RIN 3064-AD95,
RIN 3064-AD96, and RIN 3064-D97"

Re: Basel III Capital and Risk-Weighting Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comments on the Basel III proposals that were recently issued for public comment by your agencies. We specifically appreciate the opportunity to discuss our concern about the impact of these proposals – particularly the proposed capital definitions and deductions as well as the risk weighting of certain assets – on our bank and our customers.

Our bank, State Bank & Trust Company and our holding company State Capital Corporation ("SB&T"), serve the communities of central and southwest Mississippi, the Mississippi Delta, southeast Louisiana and south Alabama. As of the writing of this letter, we are approaching the $1 billion mark with approximately $930 million currently in assets.

Through acquisitions and *de novo* branch openings we have been able to expand the reach of our services, use improved economies of scale to offer customers additional services,

and bring more banking products to the citizens of Mississippi, Louisiana and Alabama. These products allow our citizens to start their own businesses, buy their own homes, and improve conditions in our communities. However, we fear that the proposed capital and risk weighting rules will have a significant and negative impact on our ability to provide these services.

The State of Mississippi – our primary market area – is unique. It is a very tough market and not just due to competition. Unfortunately, Mississippi is 1st in persons living below poverty level and infant mortality rate. Mississippi is last in median household income among the states and many other standard of living categories. These sad statistics are part of the reason that our bank recently became certified as a Community Development Financial Institution ("CDFI"). As a CDFI, we adopted the CDFI Fund's mission to "increase economic opportunity and promote community development investments for underserved populations and in distressed communities in the United States." Nowhere is this mission more critical than Mississippi and its neighboring markets. We have developed unique mortgage products to meet the credit needs of this population.

As a CDFI, we have accepted certain risks associated with our business. The loans and other financial services we provide low-to-moderate income (LMI) individuals and businesses inherently carry risks not encountered by institutions in more affluent markets. Our borrowers often cannot produce a substantial down payment or the closing costs associated with a more traditional loan. Yet our bank has learned to mitigate these risks through effective underwriting and due diligence. Despite our success with these products and consumers, the proposed rules – particularly those regarding the standardized approach to risk weighting assets – discourage the very mission that the CDFI Fund promotes.

Effects of the Proposed Rules on Our Bank

Risk Weighting Rules. In particular, our assets include a high concentration of residential mortgages that, for valid safety and soundness reasons, do not meet the definition of Category 1 loans that large, institutional banks typically have on their balance sheets. Many of our customers do not want or do not qualify for a Category 1 mortgage due to various reasons, such as no appraisal due to lack of comparables, size of the loan, or credit history. Additionally, it is not prudent for our bank to carry long term mortgage loans. Instead we believe that our customers are better served with our shorter terms balloon loans that generally renew to fully amortize the loan.

Under the proposed risk-weighting rules, the increase in risk weighting of these residential mortgage loans may triple in some cases from 50% to 150%. We currently have approximately $170 Million of these or similar loans on our balance sheet, which constitute nearly 20% of our total assets. Our Tier 1 Risk Based Capital at June 30, 2012, would drop on a proforma basis by almost 200 basis points, and our Total Risk Based Capital by approximately the same, under the proposed rules. If the proposed rules are adopted, we may be faced with the decision to protect capital and forego these loans entirely. We have limited access to raising significant capital and the bank will lose a significant source of income if it must forego these loans. The citizens of our communities could be forced to look elsewhere for such products. Their choices will be limited to large institutions – who likely won't be willing to extend credit

to these borrowers – or other lending institutions that often only give loans with truly punitive terms and conditions.

For the same reasons, the increase in risk weighting of HVCRE will stifle much of the local commercial development that is vital to our small towns. Members of the community come to our Bank for loans that will allow them to buy the real estate to start their own restaurants, convenience stores, and other businesses. If the proposed rules are adopted, we may be forced to discontinue these loans and shut out would-be business owners.

AOCI. Under the proposed rules, a revised definition of accumulated other comprehensive income ("AOCI") has been included as a component of the new Common Equity Tier 1 Capital ("CET1"). The proposed definition amends the current makeup of AOCI to include net unrealized gains and losses on available-for-sale debt and equity securities ("AFS") that must now flow through to CET1. The revision of AOCI to the capital calculation adds unnecessary volatility to capital planning by tying this component of Tier 1 capital to interest rate movements rather than credit risk. As you know, interest rates on debt securities can fluctuate daily. At June 30, our AOCI was a gain of approximately $695,000. A 100 basis point shock reduces our capital by nearly $1 Million, while a 300 basis point shock diminishes our capital by approximately $5.7 Million. These scenarios are not impossible or even unlikely. We are currently experiencing a historically low period of interest rates. Interest rates are sure to rise in the future. This volatility in AOCI represents only a snapshot in time and does not have any significant impact on our liquidity or risk to the bank. Our AFS portfolio consists of long term state, county, and municipal obligations that the issuing entities rely upon us to purchase so that they may carry out their important civic functions. The revised definition of AOCI will discourage our purchase of these obligations and thus diminish the ability of those entities to succeed.

Trust Preferred Securities. Like most community banks, we do not enjoy easy access to capital markets. Traditionally, bank holding companies such as ours have enjoyed the ability to issue trust preferred securities, often referred to as TRUPS. These instruments have provided smaller institutions like SB&T with significant amounts of low-risk, Tier 1 qualifying capital. This source of capital, among others, has allowed community banks to make the loans and provide the services its customers have come to expect. Further, these TRUPS were encouraged by the regulatory agencies and were issued in full compliance with applicable regulations. However, under the proposed rules these instruments will be phased out of the qualifying Tier 1 capital calculation over a 10 year period. Faced with this prospect, we must either raise capital during these historically slow economic times or consider reducing the size of the bank. Reducing the size of the bank would lead to less jobs for our communities and fewer services for our customers.

As you are aware, the recent financial crisis was for the most part not caused by community banks such as ours. We have remained strong through these difficult times because of our willingness to serve our communities and trust in our customers. Yet, the impact of the proposed rules will be borne disproportionately by community banks which lack the resources to implement these excessively cumbersome and complicated rules. If the proposed rules are finalized, we ask that you consider adopting the following:

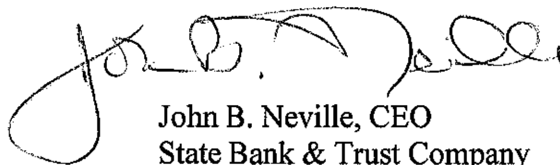
- *As originally proposed by the Basel Committee on Banking Supervision, the proposed capital rules and standardized approach to risk weighting assets did not apply to financial institutions under $10 billion. This decision reflected an understanding that such banks do not operate in the same manner as their multi-national counterparts and therefore do not pose anywhere near the systemic risks being addressed by these standards. Yet the proposed rules adopted by your respective agencies contain no such exemptions. Banks such as ours, which lack the resources, infrastructure and expertise to successfully implement these rules, should not be subject to a disproportionate burden when compared to our risk. Exempting banks under $10 billion in total assets from the Basel III minimum capital and risk weighting rules, or at least exempting such banks from the proposed rules as they pertain to the standardized approach to risk weighting assets would demonstrate an acknowledgment by the regulatory agencies that community banks such as ours play a vital and distinct role in our nation's financial system. We respectfully request that such an exemption be implemented if the proposed rules are finalized.*

- *As explained above, community banks such as ours currently do not have the technical expertise or infrastructure to retroactively apply the proposed rules to our existing assets and capital calculations. Therefore, we request that if the proposed rules are finalized, that they provide for existing assets to be grandfathered in using the current risk weighting rules. Further, we request that any application of the new rules, particularly in regard to the risk weighting of 1-4 family residential mortgages and commercial real estate, not take effect until at least January 1, 2015, in order to let community banks fully assess their probable impact and develop the infrastructure needed to implement them.*

- *The securities found in our AFS portfolio carry very little credit risk, but are vulnerable to almost non-stop fluctuations in interest rates. The revisions to the definition of AOCI makes this interest rate sensitivity flow through to Tier 1 capital, yet it does not have any measurable impact on the bank's credit risk management. If the proposed rules are finalized, we request that the definition of AOCI remain as it currently is. Likewise, we request that the existing trust preferred securities a bank or its holding company have issued be allowed to remain as Tier 1 capital without being subject to the proposed phase out period.*

Again, we sincerely appreciate the opportunity to comment on these proposed rules. We hope that you will seriously consider our comments and the effect that these rules will have on our local communities.

Sincerely,



John B. Neville, CEO
State Bank & Trust Company