SOUTHSIDE BANK

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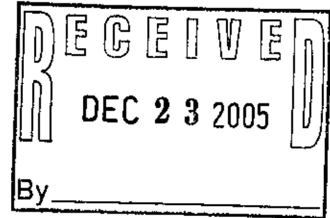


December 15, 2005

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: Proposed Revisions to the U.S. Risk-Based Capital Rules

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 over $1 billion. Southside Bank is predominately a consumer and small business oriented bank, serving all of East Texas. The company makes all types of commercial and consumer loans to local industries and residents of Smith and several surrounding counties.

We are excited to see the effort put forth for changing the current Accord in order to make it more risk sensitive and attempt to combat any competitive advantage that the Basel II banks could potentially have over community banks. This proposal is a great start, however, there are too many incomplete ideas to identify in what ways and how much it will benefit our bank.

It is our belief that any changes made to the current Accord should emphasize an institution's credit culture with strong risk analysis flowing directly to their capital requirements. The new capital requirements should benefit those with a firm understanding of underwriting. We believe that our internal risk assessment process encompasses most of the ideas driving the proposed ideas. For example, our risk rating process for a small business includes detailed financial analysis with emphasis on cash coverage as cash repays debt. It also accounts for the structure of the loan, the loan to value of the collateral, meeting policy requirements and strength of the guarantor. We have the loss history to substantiate our excellent underwriting skills. When considering a retail exposure, we carefully consider debt to income, credit scores and term of the loan along with the collateral value. 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.

We would like to address our concerns and ideas on each topic proposed:

1. Increase the Number of Risk Weighted Categories: It is our belief as well that this will help to more closely align our capital requirements with the risk sensitivity of our

portfolio. While it won't generate the same capital requirement as the Basel II proposal, it may aid in promoting fair competition with the Basel II banks. We do not see an unnecessary burden caused by this addition and we feel that the proposed categories are sufficient.

2. Use of External Credit Ratings: This proposed change will in no way affect our bank. Being a larger community bank, we do have customers with borrowings over $1 million (too big to be small business) but they are not large enough to have external credit ratings. Most of our lending would fall in the unrated category. We would like to be able to use our internal risk ratings system to better assess our risk rather than a 100% risk weight for all non-rated borrowings. The 100% risk weight is how we are currently assigning our risk weight under the 1988 Accord and will not allow us to be competitive with Basel II banks.

3. Expand Recognized Financial Collateral and Guarantors: Again, the proposed methods for expanding the recognized collateral and guarantors will surely be beneficial to the larger regional banks who have borrowers large enough to have an external rating and should not be overly burdensome. However, our customers are not of this nature. Our collateral is not typically securities, although there are some. Our guarantors are not typically companies but rather the owner of company. We do have borrowers with debt greater than $1 million, so again you are not offering a more risk sensitive risk weight but rather stuck in the 100% one size fits all category of the 1988 Accord.

4. One-to-Four Family Mortgages: We believe that using an approach that involves some level of assessment mechanism will definitely be more risk sensitive and meet the objective of this proposal. However, we feel that using just LTV after the consideration of PMI is not the most risk sensitive approach. We do practice obtaining PMI when available but there are times when the market/competition demands otherwise. We believe that a combination of LTV, credit scores and debt-to-income is a more proper risk assessment for purposes of reducing capital requirements.

   We are currently tracking our mortgage customers by credit scores in determining our levels of risk and have a proven track record to substantiate our assessments. The ability to tie the credit scores and/or LTV to the risk weight applied to a given loan with the intent being to become more risk sensitive would be appropriate. It would be a relatively simple process to update credit scores annually as well as LTVs based on original appraisals in order to remain risk sensitive.

5. Multifamily Residential Mortgages: While we do have some multifamily mortgages in our portfolio, the dollar amount is not material enough for us to have a strong opinion on this category. However, as with all of the above, we do believe that anything we can do to make our risk weights more risk sensitive will be valued.

6. Other Retail Exposures (consumer loans, credit cards, and auto loans): Further guidelines in this area are necessary in order to improve risk sensitivity. Whether or not it will benefit us depends on the guidelines put in place. A lower risk weight is appropriate in the case of well-collateralized loans with high credit scores. However, we again stress that underwriting should be the key. A combination of debt-to-income and credit scores

would be a proper assessment of risk. We are currently tracking credit scores on these types of exposures for risk purposes and have the historical data to prove up our method.

7. Short-term commitments: We do not disagree that there is some amount of credit risk in short term commitments that may need to be addressed in the risk based capital requirement. The 10% CCF is not an unreasonable number. However, without knowing the methods to be applied to the underlying assets, it would be difficult to state how this could positively or negatively affect us.

8. Loans 90 Days or More Past Due or in Nonaccrual: The method of subtracting out the reserves that are currently set aside on these types of loans would better define the remaining risk involved. However, management feels that anything higher than 100% risk weight on the amount after the specific reserves is inappropriate.

9. Commercial Real Estate (CRE) Exposures: For ADC loans, a higher rate could be justified based on high LTVs, type of project and/or financial condition of the borrower unless the exposure is in compliance with the Interagency Real Estate Lending Standards regulation. For CRE exposures as a whole, again we believe that the institution's underwriting standards should drive the capital requirement.

10. Small Business Loans: Both approaches proposed would be a definite move in the right direction to improve risk sensitivity. However, we would like to see a method that incorporates our own risk rating system which takes into account all aspects of the two methods proposed such as amortization, collateral, following policy, credit assessment of the guarantors and with a heavy weight on the financial assessment of the borrowers. We also propose the use of credit scores and debt-to-income on the principals/owners of those businesses with borrowers of less than $100K and assigning risk weights according to those scores.

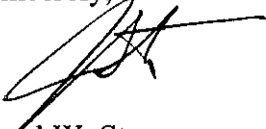
We applaud the efforts taking place to make the current Accord more risk sensitive and prevent a competitive advantage between the Basel II banks and others. However, we feel that the proposed approaches will only benefit the largest regional banks that deal with large regional and some national customers. There are a group of banks who would not have the resources to implement some of the suggestions and who would most likely want to stay under the current Accord. Then there is yet another group that we belong to – those too large to be under the current Accord, but too small to benefit from most of the proposed rules. These banks need to be taken into consideration as we do compete for business with both the Basel II banks and the larger regional banks. The solution may be in the proposed idea of having alternative approaches for some of the modifications where the bank has the option for a lower risk weight in a category as a whole or using the approaches under consideration. However, it is difficult to say without knowing exactly what those options will be and we would want to know those options prior to a final decision.

In regards to the Basel II floor, we believe that there needs to be consistent changes to avoid an unfair competitive advantage. The floor for the Basel II banks needs to be limited to any floor requirement of the competing non-Basel II banks.

Lastly, we do feel that the quarterly Call and Thrift Financial Report should include necessary information to evidence the bank's calculation of risk-based capital, but not to the extent of methodologies used. Those should be scrutinized during the on site exams.

We appreciate the opportunity to comment on the proposed revisions to the Capital Accord and anticipate that our comments will provide meaningful input to the discussion of the finalized methods to be implemented.

Sincerely,



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