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First State

October 17, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Basel III Capital Proposals

Ladies and Gentlemen:

First State Bank is a community bank from the State of Tennessee. The bank provides consumer and commercial services in communities in West, Middle and East Tennessee. For more than 125 years, First State has dedicated itself to providing our customers the best possible financial services.

We believe that community banks such as First State Bank are essential to generate employment, economic growth and financial services to small businesses and consumers.

First State Bank is a privately held community bank with $1.7 Billion in total assets. We have a structure of 32 bank branches in addition to offices that provide consumer finance lending, mortgage financing, agriculture lending, small business production, commercial lending, and insurance, trust and brokered services thought out the State of Tennessee. At this time our company has 473 employees and we continue to look at new expansion opportunities. First State Bank is concerned that the additional regulations from Basel III will interfere with this positive trend.

It is our belief that community banks should be allowed to continue using the current Basel I framework for computing the capital requirements. It is our understanding that Basel III was designed for larger international banks and not for community banks. First State Bank did not engage in the highly leveraged activities, which created the alarm in the financial markets, as did the other "big" banks.

First State Bank operates on a relationship-based business model that is specifically designed to serve customers on a long-term basis. The largest banks operate purely on transaction volume and pay little attention to the customer relationship.

Incorporating AOCI as Part of Regulatory Capital

Requiring unrealized gains and losses for available for sale (AFS) securities to flow through common equity tier 1 capital is an issue that will create significant volatility in the capital of the bank. Presently, our bank is a well capitalized institution and we have been exceeding the regulatory capital requirements under the present rules. If this new rule passes, our capital ratios will have significant volatility from one quarter to the other. What is making this troublesome is that this volatility will be created by the forces of the bond market and not by First State Bank. This situation will put us at the mercy of external forces and we won't have enough time to manage the overall risk. What is even worse under this scenario is that our customers, communities and even employees will pay the consequences by having these swings in the capital ratios. ***At First State Bank, for instance, if interest rates increased by 300 basis points, the bank's bond portfolio would go from having $ 20 million unrealized gains to show a paper loss of $ 47 million. This would mean that my bank's tier one ratio would drop by 3.89%.*** This is so significant that we strongly believe that community banks should continue to exclude AOCI from capital measures as they are currently required to do today.

New Risk Weights

This issue will interrupt the prompt economic recovery that is needed to create more jobs in our country. The framework under Basel III is too complicated and will be a heavy regulatory burden that will penalize community banks and jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize community banks who offer these loan products to their customers and deprive customers of many financing options for residential property. Community banks should be allowed to stay with the current Basel I risk weight framework for residential loans.

Proposed Phase-out of Trust Preferred Securities

Presently, our company has $27.1 million in trust preferred securities. These instruments have helped us to manage our balance sheet and growth for several years. The trust preferred securities constitutes a vital section in the capital plan that has helped us to growth and service our communities.

We object to the proposed ten year phase-out of the tier one treatment of instruments like trust preferred securities (TRUPS) because it is a reliable source of capital for community banks that would be very difficult to replace. We believe it was the intent of the Collins Amendment of the Dodd-Frank Act to permanently grandfather tier one treatment of TRUPS issued by bank holding companies between $500 million and $15 billion. Phasing out this important source of capital would be a particular burden for our bank and other privately-held companies.

We urge the banking regulators to continue the current tier one treatment of TRUPS issued by those bank holding companies with consolidated assets between $500 million and $15 billion in assets.

Finally, we know that the additional regulatory burden will significantly affect the customers and communities that First State Bank proudly services and it will go against economic growth in our nation. First State bank is opposed to the proposed approach by the federal banking agencies to implement the Basel III.

Sincerely,

Victor M Castro

Victor M Castro
Chief Financial Officer
First State Bank