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FEDERAL DEPOSIT INSURANCE CORPORATION

OCT 1 9 2012

ACCOUNTING & SECURITIES DISCLOSURE SECTION

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: Basel III FDIC RIN 3064-AD95: RIN 3064-AD96; and RIN 3064-D97.

Dear Sir:

This letter is being submitted as a comment letter in connection with the subject matter. The Bank of South Texas, McAllen, Texas ("Bank") is a small (approximately $70 million in assets) community bank that is extremely concerned about the adverse effects that will occur if the current Basel III capital requirements are implemented. In addition, please see the comments below.

The proposal requires that all unrealized gains and losses in available for sale securities ("AFS") must "flow through" to common equity tier 1 ("CET1"), a new term. This is called Accumulated Other Comprehensive Income ("AOCI"). Gains and losses in AFS portfolios happen primarily as a result of interest rate movements as opposed to changes in credit risk. Interest rates in debt securities can fluctuate frequently (often daily), and the proposed rules will cause significant volatility in capital calculations.

As stated above, the Bank has approximately $78 million in assets and at this time has approximately $11,500,000 in AFS securities. How should the Bank deal with this proposal, especially when interest rates rise again? Will the Bank be forced to create an additional capital buffer as a cushion during value fluctuations? **If so, the Bank will have to take resources from customer needs and Bank growth.** Should the Bank limit its investments in longer duration assets? How will this affect and impact local governments and housing markets? This proposal could cause a number of banks to sell all or part of their AFS portfolios. Have Federal regulators considered what impact this will have on the markets for those securities? The Bank is concerned about how this proposal might impact its asset liability function and its liquidity and contingency funding plans.

Since the Bank is A community financial institution, it should not be thrown into the "mark-to-market" frenzy that has consumed other segments of the financial services industry.

The most likely result of this proposal **will be an increase in employee time to monitor the Bank's AFS portfolio.** This may also require the Bank to **purchase software to stay in compliance. Both would lead to less time and service for the Bank's customers.**

The proposal also assigns increased risk weights for residential mortgages based on whether they are "traditional mortgages" in Category 1 or "riskier" in Category 2. The Bank will be required to re-examine all loans on the books to determine if they come under the appropriate category and LTV for each mortgage.

The Bank has approximately $20,000,000 in mortgage assets and provides mortgages in several local communities.

The most likely result of this proposal is that it will cause the Bank to raise capital. The Bank's earnings will also be impaired. The Bank's overall regulatory burden will increase. **Most importantly, it will limit the availability of mortgages in the communities where the Bank offers loan.**

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EQUAL HOUSING LENDER

It also appears that the proposal will play into the hands of the large, multistate lenders to the detriment of community banks.

And significantly, rural borrowers in Texas, due to recent federal laws, are already confronting a market in which banks are making fewer mortgage loans. This proposal will only aggravate this situation.

The proposal defines "High Volatility Commercial Real Estate" ("HVCRE") as acquisition, development and construction ("ADC") commercial real estate loans EXCEPT:

1. One-to-four family residential ADC loans; or
2. Commercial real estate ADC loans that meet LTV requirements, the borrowers' cash in the project is at least 15% of the "appraised as complete" value PRIOR to the advancement of funds by the Bank AND the borrower is required to remain in the project until the credit facility is converted to permanent financing, sold or paid in full.

HVCRE loans are assigned a 150% risk weight. Current risk weighting is 100%.

The Bank is very active in financing construction projects in its market. The Bank currently has $15,000,000 in construction projects on its books. By increasing the risk weighting to 150%, the Bank's capital will have to be bolstered, the cost of loans will increase, and the local construction industry will suffer job losses. This is especially troublesome in the McAllen area which has been one of the hardest hit communities in the nation as a result of the recession.

It is important to note that the sound management and the sound regulation of Texas banks have not led to failures. Please don't make the Texas banks pay for the sins of other institutions in the country that have failed, especially in the states of Georgia, California and Florida.

The most critical criticism the Bank has towards the proposal is the increase regulatory burden that it will cause. The proposal will require all banks to collect new and often granular information in order to calculate risk weight assets. New information will have to be obtained, maintained and reported in order to satisfy underwriting features as well as LTV features to satisfy due diligence requirements. Existing loans are not grandfathered. Information will have to be reported in different ways and with greater frequency. Monitoring capital with the new AFS requirements will also be time consuming.

The Bank is already laboring in an environment involving increased regulatory scrutiny in compliance exams and the new burdens being placed on the Bank by the Dodd-Frank Act. **Significantly, our compliance costs alone have increased 300% in the last 3 years.**

It appears that as proposed, Basel III will require the Bank to change its internal reporting systems and provide additional employee training. More than likely, the Bank will have to hire additional employees. The complexity of the data requests probably means that the Bank will also have to install new software systems and/or look for third parties to provide them. **NONE OF THESE REQUREMENTS WILL ALLOW THE BANK TO HELP ITS CUSTOMERS IN ITS COMMUNITY. THE COMPLANCE COSTS WILL PULL MONEY OUT OF CAPITAL AND EARNINGS RATHER THAN HELP THE BANK'S BORROWERS.**

The increasing cost of compliance for community banks is leading to more consolidation in the banking industry. Basel III, as proposed, will only accelerate this trend.

Federal regulators may not be troubled by a country that has only a handful of banks. From the Bank's perspective, community banks still serve a vital function in the economy. It would be a shame if these new international capital requirements help lead to the demise of community banks as we know them.

In conclusion, based upon the above, we strongly request that the Federal regulators, in preparing final rules to implement the Basel III requirement, grant community banks an outright exemption from compliance with the final rules.

Thank you.

Very truly yours,

Darryl Lemke, CEO on behalf of the Board of Directors