SOUTHSIDE BANK

P.O. BOX 1079, SOUTH BECKHAM AT EAST LAKE, TYLER, TEXAS 75710-1079 903/531-7111 Fax: 903/592-3692

JERYL STORY
SENIOR
EXECUTIVE VICE-PRESIDENT

March 22, 2007

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 approximately $1.9 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.

Banks in general have become more sophisticated in risk management since the 1988 Capital Accord. We are pleased to see that efforts are being made to help reward those with sound risk management through lower capital requirements. It is our belief that we also have taken measures to ensure strong underwriting and as a result have sound risk management. 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 appreciate this opportunity to address our thoughts, concerns and ideas as requested. However, it is still a difficult task to decide the benefits or burdens derived from Basel IA with a still incomplete proposal.

Number of Risk Weight Categories: We believe that the new proposed risk categories are appropriate as presented.

External Ratings: As previously stated, we do not see any benefits for most non-Basel II banks resulting from the use of external ratings for borrowers, guarantors or collateral. External ratings are not available for the typical non-Basel II bank's borrowers.

Public Sector Entities: We do not believe that the proposed external ratings treatment should be extended to public sector entities. We believe that the current method is risk sensitive and appropriate. It would be cost prohibitive to most of the public sector entities in our lending area to obtain an external credit rating.

1-4 Family Residential Property: The use of loan-to-value in assessing risk weights would be a plus in reaching the goal of making our current capital requirement system more risk sensitive. In addition to loan-to-value, the use of borrower credit scores would give more value to determining the overall risk of a loan and better serve the purpose of becoming more risk sensitive. We agree with and would like to see something similar to Table 3A presented in the proposal. However, we do not feel that it is our place to set the guidelines of the appropriate credit score categories. We believe that loan level PMI preferably from an unaffiliated company to the banking organization should be considered in determining the loan-to-value. Credit scores and LTV based on the original appraisal could be reassessed annually. We have the same feelings regarding the use of LTV and borrower credit worthiness on junior lien mortgages in striving to be more risk sensitive. Credit should be given to using the entire layered underwriting approach, which also takes a borrower's debt ratio into account.

HELOC: The most conservative approach to calculate LTV for a HELOC loan would be using the appraisal at funding and the total committed line amount. There would be additional undue burden to adjust the LTV as the borrower utilized the line. The proposed treatment of funded and unfunded portions of a HELOC seems appropriate. Since Texas law prohibits a loan-to-value to be more than 50% for a HELOC, the breakdown is a non-issue but an acceptable one.

Small Business: We agree with the proposal for a lower risk weight to be applied to business loans under $1 million on a consolidated business credit exposure basis. However, we would like clarification on what constitutes a consolidated basis. For example, are we consolidating two separate businesses that may share a guarantor or are we consolidating all banking products with debt exposure the business has in our bank such as credit card exposure, commercial real estate and equipment debt? We also agree with the proposal that the debt should be guaranteed by the owner, include business assets as collateral and have short term amortizations for lines of credit and 7 years or less amortization for other loans in order to lower the risk of the debt exposure.

We agree that a debt service ratio requirement would ensure proper underwriting, but may not be feasible. While not every community bank borrower can afford audited financial statements, proper underwriting techniques backed up by historical data and trends are very good indicators of debt service ability. Banks should include debt service coverage in their underwriting standards and justify their methods of calculating it, but that can vary based on type of borrower and type of financial statement received from borrowers and accounting method used (cash basis or accrual basis.)

Other Retail Exposures and Commercial Real Estate: It is imperative that the Agencies continue to consider approaches to make the current methods more risk sensitive. However, we believe that any approach should evaluate the underwriting standards used and not just the property involved. Risk layering techniques are time tested and work in all but the most serious of downturns. An approach that takes into account whether commercial real estate is owner occupied or dependent on rent income to service debt is a start but is incomplete in giving credit for the entire underwriting process just as using LTV is only one part of the process. In regards to retail exposures and other types of loans, anytime you consider a borrower's credit worthiness you are more risk sensitive than when you do not. We would like to see these incorporated into the new Basel where appropriate.

Operational Risk: Pre-judging operational risk for non-complex banks may not provide useful information. Evaluation of insurance products, historical losses and internal controls should provide a much greater basis for operational exposure. The presence of outside audits and Sarbanes-Oxley controls are mitigating factors for non-complex banks.

Basel II: We do not know how to approach the other options for other banks. Without knowing exactly what the Standardized Approach will do to existing capital requirements for the Basel II banks, it is difficult to say if we are for or against it. Without knowing exactly what will be required of us as a non-Basel II banking organization, it is hard to say how we feel about it. With the competitive environment that we face, any advantage in capital requirements translates into immediate advantage for our competition on pricing. We feel that it is the Agencies' responsibility to ensure that there are no significant competitive advantages for any bank in the United States regardless of the method required.

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,

Jeryl W. Story
Senior Executive Vice President – Senior Lender