Citizens State Bank

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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
Docket No. R-1430; RIN No. 7100-AD87
Docket No. R-1442; RIN No. 7100-AD87
Delivered via email: comments@FDIC.gov

Office of the Comptroller of the Currency
250 E. Street, S.W., Mail Stop 2-3
Washington, D.C. 20219
Docket ID OCC-2012-008
Docket ID OCC-2012-0009
Delivered via email: regs.comments@occ.treas.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
FDIC RIN 3064-AD95
FDIC RIN 3064-AD96
Delivered via email: regs.comments@federalreserve.gov

RE: Basel III Capital Proposals

Dear Sir or Madam:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

Bank Background
Our bank is a community bank in Central Texas with assets just under $400 million with six locations. The populations of the area we serve are 2,000 (our headquarters), 300, 4,000, 400, 15,000 and 7,000 (branch locations). The communities and the people we touch in these areas are very much affected by the decisions we make on loan requests, involvement of our staff of around 100 people in area wide organizations and contributions we make on an annual basis. Without our bank and what we bring to this area, the economy in our trade territory would suffer. I am very concerned that if Basel III is implemented, we will not have the ability to continue to support the economic development in our area to the level we have.

Mark to Market
My first concern has to do with the provision requiring all banks to mark to market their available-for-sale securities. Our bank has a very conservative investment philosophy. We have a portfolio of $96 million that is primarily made up of treasuries, agencies and mortgage backed securities. These investments have little, if any, risk or loss but do have an interest rate risk which we watch closely. CSB has a positive market value adjustment of $1.5 million during this period of low rates. Shock testing our portfolio by 400 points would change our capital by $6 million and drop our Tier 1 (as of 9/30/12) from 9.32% to approximately 7.75% and could cause our bank to not be able to pay salary bonuses or dividends; all of this, just because of an interest rate swing. Our bank historically holds our investments to maturity. This Basel III calculation could have huge negative impacts on our capital from this "market" adjustment and cause bankers to change their philosophy from available-for-sale to held-to-maturity and add liquidity risk not now present.

Although our bank has a lower internal lending limit than our legal limit, a $6 million swing in capital with the 400 basis point shock would change our legal limit $1.5 million and could cause community banks like ours to lose loans to the large financial institutions and reduce our income and ability to grow capital through retained earnings.

Secondary Market Guarantee
CSB does not currently sell mortgages in the secondary market but we have considered this as an additional source of income. Basel III's proposal to change capital requirements by requiring a guarantee on a portion of the loan could eliminate this as a potential source of revenue for us and other community banks.

Balloon Loans
Our loan portfolio is approximately 60% real estate secured. We hold all of our loans in our portfolio except overlines which we participate with other community banks in our area. A very high percentage of these real estate loans are "balloon" loans, approximately 75%+. This is the common structure of these loans in our region. This balloon allows us to not lock in the rate for an extended term which could put the bank in an interest rate bind. Basel III will require a doubling of capital requirements on balloon loans. This will impose a capital hardship on the community banks and require us to change to other

styles of loans with longer term fixed rates that will impose more interest rate risk on the lender.

Delinquent Loans
Increasing risk weights on delinquent loans is a redundant means of raising capital. Delinquent loans are considered in the ALLL analysis and is an area looked at closely by the regulators. This capital calculation appears to be a duplication and unnecessary addition for community banks.

Complexity
One of the major issues the community banks have to deal with is the complexity of Basel III. We have spent a great deal of time and money on technology. In our best estimation, we will have to add at least one full time person and additional software or outsource much of this capital tracking. All of this at a time when regulations are extensive and time and personnel costs are growing. There is no way to know the full impact Basel III would have on our bank because of training and assigning new risk weights to all of our loans. This is a massive task for banks our size and smaller.

Summary
It is my belief that our bank, as well as other community banks all across America, are key components of each community they serve. Their earnings and capital allow them to grow and lend money in their markets that allow businesses to grow and people to prosper. Just as these banks have the ability to take risks by lending and expanding activity, too much regulation, or restrictive regulation, will cause a tightening of lending. This will continue to slow the economic growth and restrict earnings and capital growth. Community bankers are not opposed to increasing capital to keep our banking industry safe but the regulators are doing a good job of monitoring this. Requiring the level of complex capital management that Basel III is establishing will cause undue costs and administration for community banks.

There may be a need for Bassel III with the large complex banks but not for community banks. Not all banks fit the same regulatory mold. The implementation of Basel III as proposed would significantly alter the way community banks serve their customers and communities and is not what the banking industry or our American economy need at this time. Thank you for your time and consideration to change or remove this proposal.

Sincerely,

Kenneth Knesek

Kenneth Knesek
Vice President
Citizens State Bank

cc: Senator Kay Bailey Hutchison
Senator John Cornyn
Congressman Michael McCaul
Christopher L. Williston, IBAT
Eric Sandberg, TBA