September 26, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

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:

Thank you for the opportunity to provide comment on the Basel III proposals[1] 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").

Southern First Bancshares, Inc. (Southern First) is a registered bank holding company incorporated under the laws of South Carolina. The Company consists of Southern First Bank, the 9th largest bank headquartered in South Carolina; which also does business as Greenville First Bank in Greenville County, South Carolina. Since 1999, Southern First has been providing financial services and now operates in six locations in the Greenville and Columbia markets of South Carolina. Southern First has assets of approximately $760 million.

Overall, we are concerned that a few of the rules proposed will restrict our ability to support the credit needs of our communities. I would like to take the opportunity to request that considerations be made to the following regulatory proposals:

1. **Residential Mortgage Exposures**
2. **Requiring Unrealized Gains and Losses to Flow through Capital**
3. **Phase out of Trust Preferred Securities as Capital Instruments**

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[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

Residential Mortgage Exposures

A much wider range of risk weightings are being proposed (between 35% and 200%) for residential mortgages. The proposals currently create a set of criteria differentiating between Category 1 and 2 loans (with their respective Loan to Value (LTV) risk weight buckets). Generally speaking, Category 1 loans are 1-4 Family First Lien loans that meet all of the following criteria: A) Fully amortizing with no balloon, B) Have term less than or equal to 30 years, AND C) Have documented/verified borrower income. Category 2 loans are 1-4 Family First Lien loans that do not meet the definition of Category 1 AND 1-4 Family Jr. Lien and Home Equity Loans.

A significant portion of our residential mortgage loans were originated with balloon payment features. We are able to better manage our credit risk and interest rate risk by using these balloon features. Likewise, our residential mortgages would pass the letter B and C criteria listed above. It seems clear that the intent of this paragraph was to apply a more capital intensive charge to loans commonly referred to as option loans (e.g., Option ARMs). This proposed change in residential mortgage exposures will add over $100 million of risk-weighted assets to our capital ratios and decrease our Tier 1 Capital and Total Capital ratios by over 200 basis points.

We ask that the criteria for Category 1 loans be redefined to exclude loans that "result in a balloon payment". As an example, we believe a 10-year amortizing adjustable rate mortgage loan does not have the same risk characteristics as an Option ARM or negative amortization loan.

Requiring Unrealized Gains and Losses to Flow through Capital

Basel III proposes that unrealized gains and losses on a banking organization's Available-For-Sale (AFS) securities to "flow through" to common equity Tier 1(CET1). Under the current risk-based capital rules, unrealized gains and losses that exist in accumulated other comprehensive income (AOCI) on AFS debt securities are not included in regulatory capital.

Allowing unrealized gains and losses to flow through capital would force regulators and investors to calculate alternative ratios for our Bank to determine an effective capital position, exclusive of AOCI. Likewise, we may begin using the Held to Maturity (HTM) designation for our investment securities to eliminate the potential volatility in our capital position. Moving to HTM will obviously make managing our interest rate risk and liquidity positions much more difficult.

We currently have approximately $66.4 million in investment securities available for sale with an unrealized gain of approximately $2.0 million. We currently only own agency-backed mortgage backed securities, agency-backed collateralized mortgage obligations and municipal securities. In an up 200 basis point scenario, our unrealized gain would change to a $2.8 million unrealized loss, which would create tremendous volatility in our capital position.
We ask that the proposed rule be revised so unrealized gains and losses on AFS securities that reside in AOCI would not flow through capital. This would allow unrealized losses due to credit impairment to be reflected in capital, but would exclude the interest rate impact.

Phase out of Trust Preferred Securities as Capital Instruments

Inconsistent with the intent of the Collins amendment, the proposed Basel III capital rule does not grandfather Trust Preferred Securities for institutions between $500 million and $15 billion. Instead, Basel III requires the phase-out of these instruments for bank holding companies having between $500 million and $15 billion in total consolidated assets as of December 31, 2009, permitting the inclusion of 90% of the carrying value of such instruments in 2013, with annual 10% decreases in the includible amount through 2021, until the instruments are fully phased-out on January 1, 2022.

We currently hold $13 million of Trust Preferreds out of $75 million in total Tier 1 Capital at our Holding Company. The Trust Preferreds have served as an important source of capital for our institution. The proposed change will decrease our Leverage Ratio at our Holding Company by approximately 150 basis points. The effects of both the coupon change on TARP preferred shares in 2014 and the exclusion of Trust Preferreds from Tier 1 Capital will be quite challenging for our bank.

We ask that the proposed rule should be revised to fully recognize the intent of the Collins amendment by permanently grandfathering outstanding Trust Preferred securities for institutions between $500 million and $15 billion.

Conclusion

Again, we are concerned that the rules we discussed above will restrict our ability to support the overall credit needs of our communities. We appreciate the opportunity to comment on the proposals. If you have any questions, please contact me at 803-223-6410.

Sincerely,

F. Justin Strickland
President
Southern First Bancshares, Inc.