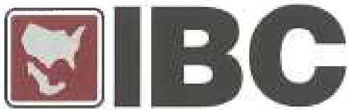

International Bancshares
Corporation

September 14, 2017

Via email Rulemaking Portal: www.regulations.gov

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
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Mail Stop 9W-11
Washington, DC 20219

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW.
Washington, DC 20429

Re: FRS – Regulation Q; Docket No. R-1571 – 12 CFR Part 217 RIN 7100-AE 83;
FDIC – 12 CFR Part 324 RIN 3064-AE 63
OCC – Docket ID OCC-2017-0012
Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations That Are Not Subject to the Advanced Approaches Capital Rules

Ladies and Gentlemen:

The following comments are submitted on behalf of International Bancshares Corporation ("IBC"), a multi-bank financial holding company headquartered in Laredo, Texas. IBC is a publicly-traded holding company that wholly-owns five subsidiary state nonmember banks serving Texas and Oklahoma. With over $12 billion in total consolidated assets, IBC is one of the largest independent commercial bank holding companies headquartered in Texas.

The Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Fed" or "Federal Reserve") and the Federal Deposit Insurance Corporation ("FDIC", and collectively, with the OCC and the Fed, the "Agencies") are inviting comment on a proposed rule that would extend the current treatment under the regulatory capital rules ("Capital Rules") for certain regulatory capital deductions and risk weights and certain minority interest requirements, as they apply to banking organizations that are not subject to the advanced approaches Capital Rules. The Federal regulatory Capital Rule requirements are very important to IBC's subsidiary banks as such requirements and preparing for their implementation significantly burdens the banks. We appreciate the opportunity to comment on the Agencies' regulatory capital proposal.

 P.O. DRAWER 1359, LAREDO, TEXAS 78042-1359 (956) 722-7611

Comments

Support for Basel III Transition Period Pause

IBC supports the Agencies pause of the Basel III transition period until projected amendments to the risk-based capital standards can be promulgated. The Basel III Capital Rule, which was finalized in 2013, included a multi-year transition period that phases in certain aspects of the rule.[1] In March 2017, the Agencies submitted a joint report to Congress as required by the Economic Growth and Regulatory Paperwork Reduction Act ("EGRPRA"). As part of the EGRPRA report, the Agencies stated that:

> The regulatory capital rules are too complex given community banks' size, risk profile, condition, and complexity. The agencies therefore are developing a proposal to simplify the regulatory capital rules in a manner that maintains safety and soundness and the quality and quantity of regulatory capital in the banking system.

The EGRPRA report further states that "amendments likely would include... simplifying the current regulatory capital treatment for MSAs, timing difference DTAs, and holdings of regulatory capital instruments issued by financial institutions..." These changes were recently further encouraged by the Treasury Secretary's report to the President regarding regulatory reform, which states in relevant part, "Regulators should simplify and improve the calculation of capital requirements for MSAs." This recommendation is in keeping with the concern that regulatory factors "unnecessarily restrict the range of choices and options" for bank customers. Treasury recommends recalibrating capital requirements that place an undue burden on individual asset classes, such as MSAs, to increase lending capacity while maintaining safety and soundness.

IBC appreciates both the intentions expressed in the EGRPRA report and in the Secretary's report to the President. We share the view that regulatory capital standards are more complex than necessary for the intended prudential supervisory value, and we are pleased that the Agencies are considering simplification efforts. This is an appropriate time to consider the effectiveness of prudential supervision standards implemented in recent years, with a view toward how they can be improved. In light of the Agencies' announced active consideration of amending the capital treatment of these exposures, IBC believes it is appropriate to pause the current transition period until simpler rules are finalized.

Proposed Rule Does Not Go Far Enough

Although IBC supports the proposed pausing of the current transition period for Basel until simpler rules are finalized, we believe that the proposal does not go far enough. This is a

[1] . During the transition period, banks will phase in the deduction requirement for the amounts of Mortgage Servicing Assets ("MSAs"), timing difference Deferred Tax Assets ("DTAs"), and holdings of regulatory capital instruments issued by financial institutions that exceed the 10% of common equity. Although currently deducted at a rate of 80%, these deductions are scheduled to be fully phased in by 2018.

sentiment shared by FDIC Vice Chairman Thomas M. Hoenig. On August 22, 2017, FDIC Vice Chairman Thomas M. Hoenig issued the following statement regarding the Agencies' proposal:

> I strongly support the prudential banking agencies' proposal to freeze the phase-in of the Basel 3 Capital Rules for community banks. Community banks engaging in traditional activities deserve meaningful relief from risk-based Capital Rules. They generally engage in less complex activities and have higher levels of tangible equity than their larger bank counterparts, yet for the most part they have been subject to the same restrictions under Basel 3. This disparity puts them at a competitive disadvantage and is one of many factors negatively impacting the sector's long term prospects.
>
> While this step to freeze the phase-in of Basel rules is important, our actions do not go far enough in providing the permanent and comprehensive relief that community banks so badly need and that I have long been advocating. Along the lines of my recommendations from 2015, such relief might be better achieved and sustained if predicated on a bank's activities and amount of tangible equity rather than asset size. Eligible banks would realize relief from not only Basel risk-based capital, but also from stress testing, appraisal requirements, exam frequency, and many other rules as outlined in the term-sheet for traditional banks. About 90 percent of the approximately 5,700 U.S. commercial banks meet the criteria defining the business activities of a traditional bank, and two-thirds have capital levels that would allow us to credibly roll back these regulations.[2]

IBC hopes the Agencies' current proposal is only the first step in a more comprehensive approach to simplifying and easing the regulatory burden for community banks.

Regulatory Burden

a. <u>Unreasonable Data Collection and Technology Burden for Community Banks</u>.

BASEL III creates an unreasonable data collection and technology burden for community banks. If the BASEL III requirements are applied to community banks, they will face the administrative burden of tracking numerous categories of deductions and adjustments to capital and changes to risk weighted assets on a quarterly basis to demonstrate compliance with three minimum capital requirements, plus the capital conservation buffer, to avoid restrictions on capital distributions and discretionary payouts. We note that Federal Reserve Governor Elizabeth A. Duke in a statement issued after the June 7, 2012 open meeting of the Board of Governors of the Federal Reserve System, stated that, "... Some parts of these proposals seem to me likely to require significant reprogramming by smaller banks. Before we impose such burdens, it is important that we understand the costs involved with each data element and weigh it against the expected improvement in the resiliency of the financial system. So I will be especially interested

[2] "Statement of FDIC Vice Chairman Thomas M. Hoenig on the FDIC Board Approval of an Interagency Proposed Rule Related to the Retention of Certain Existing Transition Provisions for Banking Organizations Not Subject to the Advanced Approaches Capital Rules" (August 22, 2017).

in commentary on the operational burden these rules might impose."[3] We strongly urge the Agencies to carefully consider the unreasonable burden BASEL IIII's requirements will place on community banks. IBC agrees with Governor Duke that IBC does not currently have the human or technological resources to complete the collection and reporting of the required information on the various asset categories on an ongoing basis in order to properly determine the risk weightings under BASEL III. IBC also agrees with FDIC Board member Thomas Hoenig's August 22, 2017 Statement on the FDIC Board Approval of an Interagency Proposed Rule Related to the Retention of Certain Existing Transition Provisions for Banking Organizations Not Subject to the Advanced Approaches Capital Rules.

It could take years for IBC to staff-up and build computer data systems capable of collecting the required granular data and to be able to run such calculations required for the risk weight analysis of BASEL III. Also, the ongoing maintenance of these systems will be burdensome and expensive. The level of information required is greater than the information necessary to make the FDIC risk assessment analysis, which upgrades to the IBC information systems took over a year and were quite expensive and time-consuming.

Such additional strain on community bank resources would serve to exacerbate the crushing regulatory burden that community banks are already facing due to the numerous new regulations required by Dodd-Frank. The costs associated with positioning the community banks to be able to make the BASEL III calculations would further challenge the income levels of community banks that are already dwindling due to the significant reductions in income related to interchange fees and overdraft courtesy fees as a result of Dodd-Frank changes. Ironically, much of the new regulatory burden is directed at "fixing" the problems that led to the 2008 financial crisis, which are problems that the community banks did not create. Community banks have recently been overwhelmed with the ongoing barrage of changes.[4] The vast majority of community banks in this country have neither the human nor financial resources to deploy toward compliance with BASEL III. There is frequent speculation that the increasing regulatory burden will cause a very significant percentage of the community banks in our nation to go out of business. FDIC Director Thomas Hoenig has long been critical of the applicability of BASEL III to community banks and has previously stated that it is illogical to apply international capital standards to community banks.[5] BASEL III will further severely burden the community banks at a time when many are at their breaking point. The credit provided by community banks is the lifeblood of our local communities and the economies of those communities will suffer if the

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[3] http://www.federalreserve.gov/newsevents/press/bcreg/20120607a.htm and at http://222.federalreserve.gov/ 20120607openmaterials.htm.
[4] These regulations include, but are not limited to, interchange fee caps; stress testing; ability to repay (Reg. Z); residential mortgage loan risk retention; foreign remittances; overdraft protection; non-resident alien deposit interest reporting; alternatives for credit ratings for debt and securitization positions; FinCEN Due Diligence; integrated Reg. Z and Reg. X mortgage loan disclosures; appraisals for higher-cost loans; high-cost mortgage and homeownership counseling amendments to Regs X and Z; mortgage loan originator compensation; arbitration clauses; and the Equal Credit Opportunity Act (Reg. B) amendments.
[5] SNL by Lindsey White, September 14, 2012.

community banking industry is unduly burdened. The added cost and burden of compliance with BASEL III is reason enough to exempt community banks from its requirements.

BASEL III is a formula and numbers driven model that could have severe, unintended consequences. Much of risk management is subjective and human intervention is essential. This is particularly true with respect to community banks that are primarily relationship lenders. This is a key difference between community banks and the global banks. Community banks actually know their customers and the judgments made by community bank lenders based on long-standing relationships with their borrowers result in the best outcomes for community banks. The formula model for capital adequacy embodied in BASEL III could actually harm community banks and could ultimately severely impact credit availability in many communities.

b. BASEL III Capital Requirements Should Not Be Applicable to Community Banks.

BASEL III was originally intended to apply solely to large internationally active, highly-interconnected financial institutions. BASEL III makes sense in the context of a systemically important financial institution ("SIFI"), but it does not make sense for community banks.[6] Community banks are not equipped to adjust to BASEL III's requirements. Community banks should not be subject to BASEL III's capital requirements because community banks focus on much smaller communities and do not transact business on a global scale. To apply BASEL III to community banks in the United States potentially endangers the future of community banking and jeopardizes the availability of credit in countless communities in our nation. Applying the BASEL III to community banks in the U.S. when significant uncertainty exists regarding the future viability of BASEL III should be avoided especially in view of the irreparable damage it could have on community banks.

Certain commentary indicates that the Fed has stated that more than 80% of the bank holding companies with less than $10 billion in total assets would meet the 7% common equity Tier 1 ratio, including the 2.5% capital conservation buffer, under BASEL III.[7] This finding does not weigh in favor of BASEL III being applied to community banks. It heavily weighs against it. It proves that BASEL III is not necessary for community banks. The costs, volatility and complexities of BASEL III are far too great to warrant the application of it to the vast majority of community banks that already have sufficient capital.

Regional and community banks were not responsible for precipitating the 2008 financial crisis. Why should regional and community banks be forced to be "fixed" along with the global banks by being subjected to the same capital standards as SIFIs? The aggregate burden of BASEL III's rigid, arbitrary and unrealistic capital requirements, along with the avalanche of new, burdensome Dodd Frank Act regulations which community banks are currently struggling to comply with coupled with the reduction in core banking fee income, will likely wipe-out many of these institutions. BASEL III's capital requirements threaten the future viability of community

[6] The BASEL Committee has identified the following factors for assessing whether a financial institution is systemically important: its size, its complexity, its interconnectedness, the lack of readily available substitutes for the financial infrastructure it provides, and its global (cross-jurisdictional) activity.
[7] Id.

banks and will significantly curb the ability of community banks to lend and provide liquidity in their local markets. This, in turn, will reduce the affordable availability of credit to consumers and small businesses, the bulk of regional and community banks' customers, further exacerbating this country's current economic difficulties. The regional and community banks that continue to make loans to consumers and small U.S. businesses will likely be forced to charge more for loans in order to meet the higher and stricter capital requirements. A study released by the Institute of International Finance finds that 40% of surveyed banking organizations able to estimate the impact of BASEL III expected that loan interest rates would increase between a half and a full percentage point, and 26% expected an even larger increase.[8] This action alone may kill community banking because of the enormous challenges these banks already face competing against tax-exempt credit unions.

The bank regulators are keenly aware of the importance of community banks and the fact that they are very different than the global financial institutions. The Federal Reserve has emphasized community bank outreach recently. For example, the Fed formed the Community Depository Institutions Advisory Counsel. In a speech given by Chairman, Ben S. Bernanke, on March 14, 2012, he commented on the unique role of the community banking industry when he stated "Community banks remain a critical component of our financial system and our economy. They help keep their local communities vibrant and growing by taking on and managing the risk of local lending, which larger banks may be unwilling or unable to do. They often respond with greater agility to lending requests than their national competitors because of their detailed knowledge of the needs of their customers and their close ties to the communities they serve."[9] Regulating the capital needs of community banks pursuant to the BASEL III complex formula model created for global banks will result in community banks being forced to lend like the biggest banks, which will no longer allow them the flexibility to be relationship lenders and to make the types of loans necessary in smaller communities that serve as the life blood of those communities. This is the essence of community banking. Without this advantage, community banks will no longer have a role to play in the financial system.

IBC believes the application of the complex BASEL III rules to community banks is regulatory overkill that could damage otherwise healthy community banks. Subjecting community banks to a one-size-fits-all modeling approach that was meant to apply to global banks is nonsensical at best and tantamount to a potentially deadly attack on the community banking industry. This is especially true in view of the adequacy of the existing community bank regulatory structure and the relative soundness of the vast majority of community banks throughout the economic crisis. Unlike the too-big-to-fail banks, the community banking industry does not present a risk to the future viability of our nation's economy. The contrast between the community banks and the too-big-to-fail banks is deftly described in Sheila Bair's book, "Bull by the Horns" where she describes the great lengths taken to rescue the nation's top banks at all cost during

[8] Paul Hannon, "Banking Organizations Tie Higher Corporate Loan Costs to BASEL III," DOW JONES NEWSWIRES, June 21, 2002.

[9] Speech by Ben S. Bernanke on March 14, 2012, to the Independent Community Bankers of America National Convention.

the economic crisis while community banks failed and consumers suffered.[10] The consideration of BASEL III was fraught with heated debate about the level of capital necessary for the too-big-to-fail banks in order to protect the financial system. Ms. Bair favored a higher level of capital.[11] Unfortunately, the debate failed to address the rationale and impact of applying BASEL III to community banks. If it had, the regulators would have realized that BASEL III should not be applied to community banks.

The Agencies should take every effort to avoid applying the BASEL III Capital Rules to community banks or regional bank holding companies like IBC and its subsidiary banks. The Agencies should exempt community banks and regional bank holding companies completely from the impact of BASEL III.

c. Disparate Negative Impact on Low-to-Moderate Income Areas

Additionally, applying the BASEL III capital requirements to all community banks with assets greater than $500 million will likely negatively impact the economic vitality in countless low-to-moderate income areas, including having a particularly negative impact on many areas with predominantly minority populations. IBC is particularly concerned about this disparate impact because IBC serves numerous low-to-moderate income communities. Low-to-moderate minority communities generally have fewer alternatives for banking services and products. We note that the FDIC's 2015 National Survey of Unbanked and Under-banked Households which revealed that more than one in four U.S. households (26.9%), are either unbanked or under-banked.[12] In Texas, 24.7% of households used alternative, non-consumer friendly, financial services, such as non-bank check cashing or payday loans, and almost one in ten households nationally have used two or more of these alternative financial services or products. In the FDIC's release of this study, FDIC chairman Martin J. Gruenberg stated that, "There are many positives to establishing a relationship with an insured financial institution. Access to an account at a federally insured institution provides households with the opportunity to conduct basic financial transactions, build wealth, save for emergency and long-term security needs, and access credit on fair and affordable terms," Gruenberg said.

We believe that application of the BASEL III capital requirements to all banks with assets greater than $500 million will have a disproportionate negative impact on minority communities. The application of BASEL III to community banks increases the likelihood that a significant number of community banks will close due to the combined impact of the crushing regulatory burden of Dodd-Frank, the reduction in the interchange and overdraft fees and the increasing pressures to raise capital presented by BASEL III. The closing of a community bank in a minority community where there are a limited number of banking institutions increases the likelihood that the minority residents of those communities will be forced to turn to high-priced alternative financial services for their banking needs.

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[10] The Washington Post, by Zoehang A. Goldfarb and Brady Dennis, September 25, 2012.

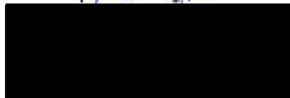
[11] American Banker, by Donna Borak, September 26, 2012.

[12] http://www.fdic.gov/householdsurvey/.

We appreciate your consideration of these important concerns and remain available to answer any questions you have regarding the issues discussed herein.

Thank you for your consideration.

Respectfully,



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