International Bancshares
Corporation

February 7, 2012

Via Email: Comments@fdic.gov

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

Re: 12 C.F.R. Part 362
Guidance on Due Diligence Requirements for Savings Associations in Determining Whether a Corporate Debt Security Is Eligible for Investment

Dear Mr. Feldman:

The following comments are submitted on behalf of International Bancshares Corporation ("IBC"), a multi-bank financial holding company headquartered in Laredo, Texas. IBC holds four state nonmember banks ranging in size from approximately $520 million in total assets to almost $10 billion. It began in 1979 as a one bank holding company holding International Bank of Commerce, Laredo, Texas, that was chartered in 1966. The three other subsidiary banks were chartered in the early 1980's. IBC grew very significantly through acquisitions during the banking turmoil in Texas of the early 90's. The lead bank has locations both in metro and small markets in Texas plus branches in Oklahoma. Thus, IBC is especially positioned to understand the challenges of this proposal to both smaller community banks as well as for large, regional banks. Further, IBC is the largest Hispanic-owned financial holding company in the continental United States with over $11.6 billion in assets. IBC is a publicly-traded financial holding company listed on the NASDAQ Global Select Market. Like many community banks in Texas, a significant portion of IBC's assets are held in investment securities.

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

Overview

The purpose of this comment letter is to address the Federal Deposit Insurance Corporation's ("FDIC") Proposed Guidance on Due Diligence Requirements for Savings Associations in Determining Whether a Corporate Debt Security Is Eligible for Investment (the "FDIC's Proposed Guidance"). Although IBC's subsidiary banks are not savings associations, the Proposed Guidance reflects the FDIC's implicit adoption of the OCC's proposed "Guidance on Due Diligence Requirements in Determining Whether Investment Securities Are Eligible for Investment," Docket Number OCC-2011-0022; RIN 1557-AD36, ("OCC Proposed Guidance"). While the OCC's proposal directly impacts state-chartered financial institutions, as is reflected in 12 C.F.R. Part 362.3[1], the FDIC, as the prudential regulator of state-chartered banks, will interpret and enforce the OCC's guidance when evaluating state-charted banks' investment portfolios. Because the FDIC's Proposed Guidance on due diligence is substantially similar to the OCC's proposed guidance and reflects the FDIC's position with respect to a bank's evaluation of investment securities, we submit the following comments which mirror the comments we previously submitted on the OCC Proposal.

Comments Submitted to the OCC

The Proposed Guidance incorporates the changes required by Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") requiring federal agencies to review regulations that require the use of an assessment of creditworthiness of a security or money market instrument and any references to, or requirements in, those regulations regarding reliance on credit ratings.

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[1] "No insured State bank may directly or indirectly acquire or retain as principal any equity investment of a type that is not permissible for a national bank" unless an exception applies.

Although the OCC Guidance recognizes that financial institutions may still consider external credit ratings, the Proposed Guidance requires financial institutions to conduct additional due diligence which may include the consideration of internal analysis, third party research, internal risk ratings, default statistics, and other applicable information appropriate for each particular security. The requirements created in the Proposed Guidance will create an undue burden and lead to increased costs for community banks.

Type I Securities

The Proposed Guidance states that "although Part 1 has no specified quality requirements for type I securities, as a matter of prudent banking practice, banks should conduct an appropriate level of due diligence prior to purchasing a material amount (to the institution) of these type I securities." Even though Dodd-Frank requires the elimination of references to credit ratings, Dodd-Frank does not require the OCC to require additional due diligence for all types of securities. As is noted by the existing segregation of types of securities in 12 C.F.R. Part 1, certain types of securities are inherently less risky than others. Likewise, 12 C.F.R. Part 1 does not entail any use of an "investment grade" standard or reference to credit ratings for type I securities. Furthermore, The OCC's Comptroller's Handbook, Section 203 Investment Securities, states that "United States government obligations are the highest quality credits," "are 'riskless' from a credit standpoint," and that "an adequate amount of such securities should be in the [bank's] portfolio." As such, type I securities, including those issued by Government-Sponsored Enterprises such as the Government National Mortgage Association ("Ginnie Mae"), the Federal National Mortgage Association ("Fannie Mae"), and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), should be exempt from additional due diligence requirements. This is especially true of securities issued by entities, such as Ginnie Mae, that are backed by the full faith and credit of the U.S. government and present no or minimal risk to a financial institution. Investing in a security that has no risk of default is to exercise prudent banking judgment, and no additional due diligence requirements should be added. Performing additional due diligence on the U.S. government backed securities, if even feasible, would serve no purpose other than to increase expenses for community banks.

The Proposed Guidance does not provide any indication as to how a financial institution could perform due diligence on the U.S. government. Furthermore, the Proposed Guidance does not provide any indication as to what level of securities would be considered "material" to an institution. Without further indication as to the type of due diligence that can be conducted against U.S. government backed securities, as well as additional guidance as to what is considered "material," too much discretion is left in the hands of examiners and regulators to criticize a financial institution's practices.

Undue Burden on Community Banks

Under the Proposed Guidance, each financial institution will need its own securities analysis department to perform the required level of due diligence or will incur additional costs through the use and management of third-party service providers. Community banks do not have large enough securities investment portfolios nor the financial resources to develop internal systems, including the hiring of additional personnel, capable of analyzing the gambit of securities products prior to making such investments and to continuously verify the credit quality of these products. As a result, community banks will be required to rely on outside, third-party services to provide this type of analyses, which is clearly tantamount to but more expensive than a credit rating agency service. Even third-party service providers may not have staff large enough to hand-price bank investment portfolios on a monthly basis. Credit information may be challenged, which would result in a financial institution needing two opinions on every bond to satisfy an examiner's review of its portfolio. The Proposed Guidance will constrain the business of banking, particularly community banking, and have the unintended consequence of further restraining lending and the economy. These new and highly burdensome compliance costs will not add one penny to the primary business of banking—making sound loans. One likely consequence is that these banking organizations may, as a result, exit all but the most conservative asset classes. For example, community banks may be forced to avoid the ownership of bonds, other than low-yielding U.S. Treasury bonds, and will be forced to invest in Fed Funds with low rates of return diminishing community bank investment opportunities and making it significantly more difficult to maintain an earnings stream for invested capital.

Credit reviews for corporate and government bonds require extensive, detailed, and time-consuming review of offering circulars. Furthermore, bonds are typically rated when presented to the market allowing the bond market to remain fluid and liquid. Bond purchases require instant decision making, which makes the use of credit ratings critical to a smoothly operating bond market. In most cases, by the time a bank and/or third party provider could complete its credit review of corporate bonds, the bonds will already have been sold. This practice if imposed on banks will have the unintended consequence of leading to less-diversified investment portfolios for community and regional banks and further restraining lending and damaging this country's fragile economic recovery.

Maintaining an Appropriate and Effective Portfolio Risk Management Framework

In addition, the Proposed Guidance makes the implicit assumption that examiners and regulators are better equipped to manage the risk of a bank's investment portfolio than the bank itself. Successful financial institutions, especially those that are publically traded, already manage investment risk based on the standards contained in the Proposed Guidance. The Proposed Guidance provides no criteria or structure for assessing investment risk; thus, the Proposed Guidance assumes that regulators are better able to determine what investment choices are "right" versus what investment choices are "wrong."

Over time, regulators may try to apply certain investment management best practices to all institutions, which could have the unintended effect of dictating a one-size-fits-all investment strategy program for banking organizations. One-size-fits-all scenarios or techniques will not allow banks to appropriately diversify their investment portfolios. It is misguided to believe that regulatory micromanagement of banks' investment practices will lead to economic improvement amongst banks. Finally, another likely negative consequence is that examiners will likely second-guess the non-credit rating agency analysis relied upon by banks.

Alternatives

A. Limited Credit Rating Utilization Alternative

We encourage the banking agencies to acknowledge that banks may reasonably rely on credit ratings on debt instruments such as general obligation municipal bonds, the obligations of major corporations, and pass-through mortgage backed securities fully collateralized by conforming mortgage loans. The alternative to this approach is to exclude banks from much of the new-issue market and to encourage less-diversified investment portfolios for banks unable to meet the Proposal's requirements.

B. Community Bank Alternative

We believe another more appropriate and balanced alternative to the Proposed Guidance is to require community and regional banks to obtain sufficient ratings from two third-party sources and to provide greater oversight of the existing rating agencies. The widely publicized instances where the reliance on credit ratings at large complex banking organizations has exposed the financial institutions to undue risk should not be used to taint the established investment management programs of community banks that do not present such undue risk and have not had negative safety and soundness examination findings. Rather than presenting undue risk, the investment management programs of community and regional banks are generally straightforward. In any event, bank regulators are already authorized to prohibit any undue risk or problematic investment programs identified during an examination. As support for a two-tier approach for the measurement of risk, in a January 12, 2012, ICBA meeting with the new CFPB Director, Richard Cordray, Mr. Cordray indicated that he would be open to having certain future regulations be two-tier or have one or more exemption thresholds in the regulation that would permit community banks to have less burdensome regulatory requirements imposed on them.

C. Alternative Based on Proposed Revised "Investment Grade" Definition for National Banks.

The OCC's investment securities regulations generally require a bank to determine whether or not a security is "investment grade" in order to determine whether purchasing the security is permissible. Under the Proposed Guidance, a security would be "investment grade" if the issuer has an adequate capacity to meet financial commitments under the security for the projected life of the security. To meet this new standard, banks would have to determine that the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected and could consider a number of factors, as appropriate such as internal analyses, third-party research and analytics including external credit ratings, and internal risk ratings, default statistics, and other sources of information as appropriate for the particular security. Under the Proposed Guidance, banks would have to supplement the credit ratings with increased due diligence processes and analyses that are appropriate for the bank's risk profile and for the amount and complexity of the debt instrument, including, incredibly, type I securities issued or backed by the U.S. Government which are inherently less risky than other types of securities. If there is some fair and equitable manner to implement a specific risk-weighting factor for corporate debt positions based on whether the position is "investment grade," as that term is defined in the OCC's regulations, we would support such an approach so long as unreasonable and burdensome due diligence requirements are not imposed on community and regional banks. For example, the new definition of "investment grade" for corporate and government debt positions could acknowledge that credit ratings are a reasonable means of satisfying the requirement that securities be investment grade for banks, and in particular, community and regional banks. Otherwise, we believe the Proposed Guidance will create an undue burden and lead to significantly increased costs for community and regional banks and will leave too much discretion in the hands of examiners and regulators to criticize a bank's practices.

Furthermore, these comprehensive analyses will apply to local government securities, like bonds issued by municipalities, counties, and school districts. Community and regional banks have been a significant source of funding for these critical governmental functions.

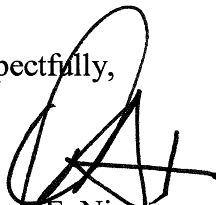
The additional costs imposed on banks to acquire and maintain these in their investment portfolios could either reduce the market for such investments or potentially drive the price up. Either consequence will harm the ability of local government to prudently invest in needed infrastructure.

Transition Period

We strongly urge the FDIC and the other Federal bank agencies to provide a reasonable transition period for compliance with the OCC's and the FDIC's Proposed Guidance when they are issued in final form. This is necessary, we believe, because of the complexity of the Proposed Guidance and the far reaching effect they have on banks. Banks of all sizes will very likely be required to establish or upgrade in-house systems, analytical capabilities and/or management capabilities. As a result, we recommend that the FDIC's enforcement of the OCC's Proposed Guidance, provide a transition period of at least one year before compliance is required with the Proposed Guidance

Thank you for this opportunity to comment.

Respectfully,



Dennis E. Nixon
President and CEO