International Bancshares Corporation

January 27, 2012

Via E-Rulemaking Portal: http://www.regulations.gov

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

Re: FDIC; RIN 3064-AD70
Risk-Based Capital Guidelines: Market Risk; Alternatives to Credit Ratings for Debt and Securitization Positions

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. It is a publicly-traded financial holding company listed on the NASDAQ Global Select Market.

Overview

The FDIC and other Federal bank agencies are seeking comment on an amendment to the notice of proposed rulemaking ("NPR") to modify the agencies' market risk capital rules, published in the Federal Register on January 11, 2011.

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

The January 2011 NPR did not include the methodologies adopted by the Basel Committee on Banking Supervision ("Basel Committee") in 2009 for calculating the standard specific risk capital requirements for certain debt and securitization positions, because the Basel Committee methodologies generally rely on credit ratings. In particular, the Basel Committee finalized its "Revisions to the Basel II Market Risk Framework." The Basel Committee revised the framework, in part, to eliminate arbitrage between the banking book and trading book. Generally, the Basel revisions apply the banking book capital treatment, a ratings-based approach, to securitizations held in the trading book.

However, under Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), all federal agencies must remove references to and requirements of reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness. In the Proposal, the agencies are proposing to incorporate into the proposed market risk capital rules various alternative and complex methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings. The Proposal offers alternatives to the ratings-based approach for securitizations in the trading book, not the banking book. The Federal bank agencies have not yet removed references to credit ratings in the existing banking book capital rules. While IBC does not have a trading book and includes all of its securities investments in its banking book, IBC is commenting on the NPR because it is concerned that alternative methodologies for calculating risk capital requirements for the trading book will ultimately be applied to the banking book, which concern is heightened by the Basel revisions applying the banking book capital treatment, a ratings-based approach, to the securities held in the trading book.

The stated objectives of the Proposal's amendments are that any alternative creditworthiness standard should, to the extent possible:

- Appropriately distinguish the credit risk associated with a particular exposure within an asset class;

- Be sufficiently transparent, unbiased, replicable, and defined to allow banking organizations of varying size and complexity to arrive at the same assessment of creditworthiness for similar exposures and to allow for appropriate supervisory review;
- Provide for the timely and accurate measurement of negative and positive changes in creditworthiness;
- Minimize opportunities for regulatory capital arbitrage;
- *Be reasonably simple to implement and not add undue burden on banking organizations* [Emphasis added]; and,
- Foster prudent risk management.

IBC does not hold sovereign debt, but as to corporate debt, the FDIC and other Federal bank agencies are considering various options including whether to permit banks to determine 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 at 12 C.F.R. Section 1.2(d). For example, under such an approach, an investment grade exposure might be assigned a risk-weighting factor of 6.0 percent and a non-investment grade exposure might be assigned a risk-weighting factor of 12.0 percent. This proposed analytical method is discussed more fully in part C. of the "Alternatives" section of this letter.

Undue Burden on Community Banks

In the Proposal, the FDIC and the other Federal bank agencies expressly request comment regarding whether the proposed revisions strike an appropriate balance between measurement of risk and implementation burden in considering alternative measures to creditworthiness and what operational challenges, if any, banks would face in implementing alternative methodology to measuring creditworthiness. We appreciate how difficult it will be for the Federal bank agencies to develop substitutes for credit agency ratings as mandated by Dodd-Frank.

However, we believe that, in practice, the Proposal's requirements will be impossible to reasonably reconcile with the stated objective that the regulation's risk-based capital requirements be reasonable and practical to implement and not unduly burdensome on community or regional banks. Community and regional banking organizations do not have 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. . Community and regional banks will be required to rely on outside, third party service providers to perform the analysis, which will be tantamount to, but more expensive, than a credit rating agency service. These new and highly burdensome compliance costs that 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, credit reviews for corporate and government bonds require extensive, detailed, and time-consuming reviews of offering circulars. In most cases, by the time a bank and/or third party provider could complete its credit review of the 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. Finally, another likely consequence is that examiners will second-guess the non-credit rating agency analysis relied upon by banks.

Inconsistent with Basel III Implementation

The elimination of credit ratings will complicate U.S. adoption and implementation of Basel III, and make it difficult to achieve consistent global implementation. We believe that the agencies should consider consistency with international capital standards as a goal of the new creditworthiness standards, and permit the United States to implement the changes to risk-based capital rules required by the revisions to Basel II and Basel III.

The Basel II market risk rules and proposed Basel III are already tackling the issue of undue reliance on external credit ratings by requiring banking organizations to supplement regulatory capital requirements based on externally rated securitizations with their own credit analysis and capital estimates of the exposure.[1] Without a broadly consistent global approach to creditworthiness standards for securities, including securitizations, the agencies run the risk of encouraging regulatory arbitrage and of accentuating systemic risk.[2] Indeed, from a narrow U.S perspective, existing banking book and trading book rules still need to be made consistent to avoid regulatory arbitrage.[3] As previously noted, the Proposal offers alternatives to the ratings-based approach for securitizations in the trading book, not the banking book.

Alternatives

A. Limited Credit Rating Utilization Alternative

In the Proposal, the FDIC and the other Federal bank agencies expressly request comment regarding whether there are other alternatives permissible under section 939A of Dodd Frank that strike a more appropriate balance between measurement of risk and implementation burden in considering alternative measures to creditworthiness. We encourage the FDIC 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. This unfortunate outcome could raise serious safety and soundness concerns.

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[1] January 6, 2012 comment extension request letter to the Board of Governors of the Federal Reserve System from The Clearing House, The Financial Services Roundtable, and the American Bankers Association.
[2] *Id.*
[3] *Id.*

B. Community Bank Alternative

We believe another more appropriate and balanced alternative to the Proposal 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.

In the Proposal, the FDIC and the other Federal bank agencies expressly request comment regarding whether to permit banks to determine 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 at 12 C.F.R. Section 1.2(d). For example, under such an approach, an investment grade exposure might be assigned a risk-weighting factor of 6.0 percent and a non-investment grade exposure might be assigned a risk-weighting factor of 12.0 percent. 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 OCC's recently proposed revisions, 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.[4] 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 OCC revisions, national 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. Due diligence requirements could be imposed when necessary to determining that an unrated security is the credit equivalent of investment grade, and performing post-purchase monitoring of investment securities. Otherwise, we believe the Proposal 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.

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[4] 76 FR 73526 (November 29, 2011).

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 Proposal's requirements when it is issued in final form. This is necessary, we believe, because of the complexity of the Proposal and it's far reaching effect 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 any final rule provide a transition period of at least one year before compliance is required with the requirements of the Proposal when issued in final form.

Thank you for this opportunity to comment.

Respectfully,

Dennis E. Nixon
President and CEO
International Bancshares Corporation