International Bancshares Corporation

September 22, 2020

Via email submission to Comments@fdic.gov.

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

Re: Comments on Request for Information on Standard Setting and Voluntary Certification for Models and Third-Party Providers of Technology and Other Services (RIN 3064-ZA18)

Dear Sir:

The following comments are submitted by International Bancshares Corporation ("IBC"), a publicly-traded, multi-bank financial holding company headquartered in Laredo, Texas. IBC maintains 187 facilities and 284 ATMs, serving 88 communities in Texas and Oklahoma through five separately chartered banks ("IBC Banks") ranging in size from approximately $397 million to $9 billion, with consolidated assets totaling approximately $12.5 billion. IBC is one of the largest independent commercial bank holding companies headquartered in Texas.

This letter responds to the Request ("Request") of the Federal Deposit Insurance Corporation ("FDIC") for information on standard setting and voluntary certification for models and third-party providers of technology and other services ("Vendors").

Like most financial and depository institutions, IBC and IBC Banks have substantial, complex, and system-critical relationships with numerous technology and model Vendors. IBC and IBC Banks have relationships with seventy-seven (77) technology Vendors and use eight (8) third-party models throughout the businesses. The current regulatory and prudential burden of on-boarding and negotiating, conducting due diligence, and winding up relationships with Vendors results in wasted and duplicative time and effort. Together, IBC and IBC Banks spend roughly $160,000 annually on their Vendor Management Department annually. This does not include the cost of contracting, or the additional cost of our IT Department's involvement or our audit and management oversight costs. Those costs are difficult to calculate because it is difficult to isolate all of the actions, time, and effort spent specifically on CIP requirements, as well as numerous factors and CIP-adjacent issues that may need to be considered. This amount also does not include the cost of attorney negotiation, drafting, and review of our agreements with Vendors. One way the regulatory and prudential burden on insured institutions is currently lightened is through standard setting organizations ("SSO") and related voluntary certifications and

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certifying organizations ("CO"). Current SSO and certifications that assist insured institutions in meeting due diligence, on-boarding, and monitoring and reporting requirements include Basel III, SOC 2 Type II, and the National Institute of Standards and Technology ("NIST"). By promoting the creation and growth of more SSOs, COs, and voluntary certifications, FDIC can support a decreased regulatory and prudential burden on insured institutions in their relationship with Vendors, which will result in more competition in the financial services industry and will foster increased innovation and creativity in financial products and services.

Pursuant to the Request, FDIC is soliciting information regarding new SSOs, COs, and voluntary certification processes for models and Vendors.

The Request lists twenty-six specific topics and regarding which FDIC would like feedback. IBC has provided comments to the specific issues as noted below.

<u>**GENERAL**</u>

Question 1: Are there currently operational, economic, marketplace, technological, regulatory, supervisory, or other factors that inhibit the adoption of technological innovations, or on-boarding of third parties that provide technology and other services, by insured depository institutions (IDIs), particularly by community banks?

> **Response:** The volume of due diligence data and paperwork necessary to negotiate with and on-board a Vendor or to implement a model is staggering and could easily be reduced with appropriate standard-setting voluntary certifications. Moreover, IBC Banks are required to conduct an annual security attestation for many of their Vendors. This burden is a hurdle to engaging new Vendors, as each new Vendor represents an additional certification that is necessary. If, instead, Vendors were able to be independently reviewed and certified, and insured institutions could rely on such certification, it may be possible to decrease the burden of on-boarding and working with multiple new Vendors.

Question 2: What are the advantages and disadvantages of establishing standard-setting and voluntary certification processes for either models or third-party providers?

> **Response:** A large amount of time and effort spent on model and Vendor on-boarding is simply duplicative of work and time spent by either the Vendor or its previous or current customers. One Vendor could be engaged with a number of insured institutions, which are all subject to the same due diligence, annual reporting, and monitoring requirements. To the extent those requirements can be met by the Vendor voluntarily being reviewed and certified by an SSO or CO, the regulatory and reporting burden on insured institutions could decrease precipitously. Already certain standard-setting voluntary certifications are used to more efficiently conduct due diligence and on-board Vendors and models, such as SOC 2 Type II certification. Additionally, model or Vendors would face a decreased logistical burden of providing access to systems testing and other due diligence requirements to all of its insured institution clients. Instead, such Vendors may

simply go through any required testing or review one time and provide evidence of its successful completion to each of those customers.

IBC notes that any standard-setting voluntary certification ultimately approved by FDIC should be truly voluntary. No Vendor or insured institution should face increased regulatory scrutiny for not participating in the certification. That is not to say an insured institution should not have to meet the same standards as currently required of them in respect to a model or Vendor, but the relationship should not be more heavily scrutinized than it would have been under the current regulatory regime.

Question 4: What are the advantages and disadvantages to an IDI, particularly a community bank, of participating in the standard-setting and voluntary certification process?

Response: As noted elsewhere, decreased time and resources used in completing due diligence, on-boarding, and annual/regular monitoring and reporting are clear advantages. IBC expects an increase in standard-setting and voluntary certification will result in more opportunities to work with new Vendors, models, and related products and services.

The due diligence and other regulatory burdens that insured institutions are required to pass down to their third-party vendors are not small. If that burden was decreased by using SSO and/or CO certification to meet certain requirements, the market would likely see a flood of new and innovative services, products, models, and Vendors. This would likely drive a similar increase in innovative banking products and services that insured institutions provide, potentially opening up previously under- and unserved populations and markets.

SSO and CO certifications could also allow faster and easier Vendor, model, and service comparisons, supporting an insured institution's ability to shop for the best product, service, and provider. This, along with the decreased barrier to entry discussed above, would increase competition in the financial services marketplace.

A potential disadvantage of SSO and/or CO certification may be that Vendors and models become more expensive, given the sunken, recurring operational cost of certification. However, any cost increase would likely be outweighed by a mirror decrease in cost of due diligence, on-boarding, monitoring, and reporting currently required of insured institutions. Thus while the prices of models and Vendor products/services may increase, there would likely be a complementary decrease in an insured institution's cost of regulatory and prudential compliance related to the model or Vendor.

Question 5: Are there specific challenges related to an IDI's relationships with third-party providers of models or providers of technology and other services that could be addressed through standard-setting and voluntary certification processes for such third parties?

(1) Are there specific challenges related to due diligence and ongoing monitoring of such third-party providers?

Response: Due diligence and ongoing monitoring and reporting requirements related to Vendors and models is incredibly costly and duplicative. Most Vendors to insured institutions are engaged with multiple insured institutions. It is clearly more efficient to have each Vendor have the ability to conform to a universal standard and receive certain certifications than to have each insured institution customer redundantly certify, review, test, monitor, or confirm the same. Moreover, the sheer time and effort needed to comply with current due diligence and monitoring requirements makes it difficult to have a multitude of Vendor relationships, or to switch Vendors. The ability to contract with more Vendors and to switch between Vendors more easily will increase competition and the quality of financial products and services that insured institutions are able to offer.

(2) Are there specific challenges related to the review and validation of models provided by such third parties?

Response: The Request states that the FDIC is not considering substantive revisions to its existing supervisory guidance with respect to model risk management. However, the FDIC is seeking comments on changes to supervisory guidance that would be appropriate to facilitate the use of a voluntary certification program. The model risk management guidance is clear that "banks are expected to validate their own use of vendor products", which is the largest cost driver in the adoption of third-party models. IBC and IBC Banks' model validation increases the annual cost of the third-party models by as much as 50% to 100%. In order for voluntary certifications to be useful, IBC believes that the model risk management guidance needs to be substantially revised to address the usage of third-party model certifications. In addition, to be successful in reducing the cost of third-party model adoption, the following items should be considered:

1. Voluntary model certifications should aim to fully test and validate the model across a broad spectrum of setups, calibrations, and/or assumption settings. This has the potential of reducing the scope of the insured institution-specific ("own use") validation and in turn the cost of using third-party models.
2. Voluntary model certifications reports should clearly state the extent in which an insured institution can rely on the certification within the validation. For example, if the focus of validation is to ensure proper setup, calibration, and/or assumption setting of a third-party model, then the certification should clearly state the remaining items that need to be validated by the insured institution. This has the potential of reducing scope creep within an "own use" validation and, in turn, the cost of using third-party models.

3. The model risk management guidance should be revised to allow insured institutions to rely on model certifications when scoping validation requirements.
4. IBC believes that without reducing the burden of independent model validations required in the model risk management guidance, community banks will continue to face high costs in technology adoption. The model risk management guidance should be revised to remove the requirement of independent validation since the guidance requires model owners to test the overall functioning of the model to ensure it is performing as intended.

Questions 6: Would a voluntary certification process for certain model technologies or third-party providers of technology and other services meaningfully reduce the cost of due diligence and on-boarding for:

(1) The certified third-party provider?
(2) the certified technology?
(3) potential IDI technology users, particularly community banks?

Response: Yes, for all three. For the first two, costs will be decreased throughout the lifecycle of their relationship with the insured institution, from negotiation to final termination. The up-front time and costs will be decreased by eliminating, or nearly eliminating, certain requirements that are now met through compliance with SSO standardization and voluntary certification, and annual reporting and monitoring costs will be decreased in the same manner. This decrease will result in more time and resources being available for other tasks and matters, such as customer service and innovation. Moreover, less time spent during model and technology verification and implementation means more productive up-time of said model or technology.

Question 8: Would a voluntary certification process undermine innovation by effectively limiting an IDI's discretion regarding models or third-party providers of technology and other services, even if the use of certified third parties or models was not required? Would IDIs feel constrained to enter into relationships for the provision of models or services with only those third parties that are certified, even if the IDIs retained the flexibility to use third parties or models that were not certified?

Response: Of course, there may be many conservative insured institutions who will only engage SSO/CO-certified Vendors or models if such a certification regime is built-out. There will also be insured institutions that choose only SSO/CO-certified Vendors and models for services and products that are new or higher risk, while using non-certified Vendors or models for traditional or low-risk products and services. However, IBC believes that by building an SSO/CO certification regime for insured institution Vendors and models, competition, and thus the marketplace, will flourish. SSO/CO certification should lower the barrier to entry for startups and industry disruptors. It will also bring a level of standardization and confidence to the marketplace, which will likely improve the working relationships between insured institutions and their Vendors.

Question 9: What supervisory changes in the process of examining IDIs for safety and soundness or consumer protection would be necessary to encourage or facilitate the development of a certification program for models or third-party providers and an IDI's use of such a program? Are there alternative approaches that would encourage or facilitate IDIs to use such programs?

Response: IBC does not agree that the FDIC would need to encourage or facilitate an SSO/CO or certification regime. Rather, the certification regime would grow and become adopted as regulators and examiners accept the results of such certifications to streamline and bring standardization and confidence to the examination process.

Question 10: What other supervisory, regulatory, or outreach efforts could the FDIC undertake to support the financial services industry's development and usage of a standardized approach to the assessment of models or the due diligence of third-party providers of technology and other services?

Response: In support of an SSO/CO certification regime, FDIC should decrease examination scrutiny on certified Vendors, provide template contract language to be used with Vendors, and a safe harbor to suspend, exit, or remediate contracts if Vendors or models become the subject of regulatory supervision or enforcement or otherwise have their certification revoked.

SSO

Question 16: To what extent would a standards-based approach for models or third-party providers of technology and other services be effective in an environment with rapidly developing technology systems, products, and platforms, especially given the potential need to reassess and reevaluate such systems, products, and platforms as technologies or circumstances change?

Response: IBC does not anticipate a standards-based approach would be any less effective than the current redundant, inefficient, and near-constant monitoring, reporting, investigating, and due diligence performing. The standards should be evaluated at least annually and monitored for potential issues requiring more frequent attention. If a standard does become obsolete, FDIC should guarantee a safe harbor for transitioning to an alternative or certifying a correction or amendment to ensure institutional and market stability.

Question 20: To what extent should the FDIC and other Federal/state regulators play a role, if any, in an SSO? Should the FDIC and other Federal/state regulators provide recommendations to an SSO? Should the FDIC and other Federal/state regulators provide oversight of an SSO, or should another entity provide such oversight?

Response: A new SSO/CO certification regime for Vendors and models should include the input and participation of all applicable federal regulators, as well as sufficient outreach to, and input and participation from, state and prudential regulators.

CERTIFICATION ORGANIZATIONS (COS)

Question 24: If COs receives derogatory information indicating that a certified third party or certified model or technology no longer meets applicable standards, should the COs develop a process for withdrawing a certification or reassessing the certification?

(1) If so, what appeal rights should be available to the affected third party?
(2) What notification requirements should COs have for financial institutions that have relied on a certification that was subsequently withdrawn?
(3) Should the FDIC or Federal/state regulators enter information sharing agreements with COs to ensure that any derogatory information related to a certified third party or certified model or technology is appropriately shared with the COs?

Response: As noted herein, IBC believes that there should be safe harbor provisions for insured institutions who rely on such SSO/CO certifications. Those rights could change depending on the action. For example, if a model certification is withdrawn, insured institutions would have a certain number of days to either conduct independent due diligence on a conforming change to the model, implement an alternative compliant model, or to discontinue use of the de-certified model.

Question 25: Are there legal impediments, including issues related to liability or indemnification, to the implementation of a voluntary certification program that the FDIC, other Federal/state regulators, third-party providers, and IDIs should consider?

Response: Insured institutions may face liability immediately upon a certification being withdrawn or disqualified. In order to protect the stability of the industry, FDIC should provide a safe harbor.

Thank you for the opportunity to share IBCs views on these matters.

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INTERNATIONAL BANCSHARES CORPORATION

Dennis E. Nixon, President and CEO