IBC
International Bancshares
Corporation

October 19, 2012

Via "www.regulations.gov"

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

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

Re: FDIC Docket ID: FDIC-2012-0100, RIN 3064-AD95 and FRS Docket ID: FRS-2012-0246, RIN 7100-AD87; Regulatory Capital Rules: Regulatory Capital, Implementation of BASEL III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action (FRB: Regulations H, Q and Y) (FDIC: 12 C.F.R. Part 324)

Dear Ms. Johnson and Mr. Feldman:

The following comments are submitted on behalf of International Bancshares Corporation ("IBC"), a multi-bank financial holding company headquartered in Laredo, Texas, with approximately $11.9 billion in total assets. IBC holds four state nonmember banks ranging in size from approximately $520 million in total assets to almost $10 billion. IBC is the largest Hispanic-owned banking organization in the continental United States. IBC is well-positioned to understand the challenges of this proposal. Each of the IBC four subsidiary banks is a community bank with less than $10 billion in assets. Many of the markets that IBC serves are low income minority communities that offer limited banking alternatives.

On June 12, 2012 the Federal banking agencies (the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation) (the "Agencies") formally proposed for comment three separate, but related proposals (each a "Proposal," and collectively the "Proposals"), that would significantly revise the regulatory capital requirements for all U.S. banking organizations with over $500 million in assets by, among other things, implementing the BASEL III capital reforms and incorporating various Dodd-Frank-related capital provisions.

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Based on the core requirements of the 2011 International BASEL III Accord ("BASEL III"),[1] and in significant part on the "standardized approach" for the weighting and calculation of risk-based capital requirements under the 2004-2006 BASEL II Accord ("BASEL II"), the Proposals will extend large parts of a regulatory capital regime that was originally intended only for large, internationally active banks to all U.S. banks and their holding companies, except for the smallest bank holding companies (generally, those with under $500 million in consolidated assets).

I. Overview of Proposal

The Proposal is complex and required approximately 700 pages. The Proposal sets forth minimum regulatory capital requirements and a standardized approach for risk-weighted assets. With respect to community banks, the Proposal would:

1) Revise the definition of regulatory capital components and related calculations;
2) Add a new Common Equity Tier 1 Risk-Based Capital Ratio;
3) Incorporate the revised regulatory capital requirements into the Prompt Corrective Action regulatory framework;
4) Implement a new Capital Conservation Buffer;
5) Revise rules for calculating risk-weighted assets; and
6) Provide a transition period for several aspects of the Proposal.

The Proposal includes a new definition of Common Equity Tier 1 and includes the new component of "Accumulated Other Comprehensive Income" that factors into the calculation of Common Equity Tier 1 all net unrealized gains/losses on available-for-sale securities. The definition also establishes the expectation that the majority of Common Equity Tier 1 will be voting shares. The Proposal creates a category referred to as "High Volatility CRE" ("HVCRE") which would have a risk weight of 150% and generally include nonresidential acquisition, development or construction financing.

The Proposal also would establish calculations for risk-weighted assets using alternatives to credit ratings that would be based on either the weighted average of the underlying collateral or a formula based on subordination position and delinquencies or the use of a 1,250% risk-rating, which would be the default rating if requisite standards of a comprehensive understanding and levels of due diligence are not met. Securitized structures such as private label mortgage-backed securities may be risk weighted based on a gross-up approach considering underlying assets otherwise they default to 1,250% risk weight.

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[1] BASEL Committee on Banking Supervision ("BASEL Committee"), BASEL III: A global regulatory framework for more resilient banks and banking systems (Dec. 2010; rev. June 2011).

II. Comments

A. General.

As a Texas financial institution that survived the S&L crisis of the 1980's, IBC thoroughly recognizes the importance of appropriate levels of capital as a key component of a safe and sound financial institution. IBC is a well-capitalized financial institution that continues to be completely committed to maintaining adequate levels of capital. The IBC capital ratios significantly exceed the well-capitalized thresholds. The existing capital rules are sufficient for community banks like the IBC subsidiary banks and regional bank holding companies like IBC.

We strongly object to applying the overly-complex set of BASEL III capital rules to community banks or regional bank holding companies. Nothing positive will be gained from applying the BASEL III capital rules to community banks, but the negative consequences of doing so could result in the demise of numerous community banks and jeopardize the future of community banking. Community banks and regional bank holding companies are very different than their too-big-to-fail global counterparts. The business model of community banks is very simple and straight-forward compared to the complicated models of banks competing in the global arena. Complex capital rules drafted for global banks should not apply to community banks. We will comment on key parts of the Proposal below in order to demonstrate how the Proposal would negatively impact the IBC subsidiary banks and fail to enhance the regulation of IBC's capital levels.

B. Unreasonable Data Collection and Technology Burden for Community Banks.

The Capital Proposal creates an unreasonable data collection and technology burden for community banks.

Banks will now 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 in commentary on the operational burden these rules might impose."[2] We strongly urge the Agencies to carefully consider the unreasonable burden the Proposal's requirements will place on community banks.

[2] http://www.federalreserve.gov/newsevents/press/bcreg/20120607a.htm and at http://222.federalreserve.gov/ 20120607openmaterials.htm.

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 the Proposal.

IBC also agrees with FDIC Board member Thomas Hoenig who said in a speech at the American Banker's Regulatory Symposium on September 14, 2012, that the Proposal is "too complex" and "would put smaller firms with fewer resources at a competitive disadvantage."[3]

For example, for investments in mortgage backed securities and other asset-backed securities ("ABS"), there are proposed major changes in risk weighting as banking organizations can no longer rely on outside credit ratings to determine the appropriate risk weighting. The bank may either use the gross up method or the Simplified Supervisory Formula Approach ("SSFA") method to risk weight investments. Under the gross-up method, investments in the senior secured tranches are assigned the risk weighting associated with the underlying exposures. With respect to subordinate tranches, a banking organization must hold capital for the subordinate tranche as well as the senior tranche for which the subordinate tranche provides credit support.

A banking organization may also use the SSFA that calculates the weighted average risk weighting of the underlying exposures adjusted for the attachment and detachment points of the particular securitization positions and the delinquencies within the underlying collateral. Either of these approaches would require a banking organization to prepare detailed spreadsheet analysis to track their investments and is expected to introduce significant administrative burden in addition to higher capital requirements.

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. 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 upgrade to the IBC information systems took over a year and was 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.

[3] American Banker, by Alan Kline, September 17, 2012.

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 these proposals. 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. The opposition to the application of BASEL III to community banks has been growing recently.

FDIC Director Thomas Hoenig is critical of the BASEL III Proposal and has recently 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 community banking industry is unduly burdened. The added cost and burden of compliance with BASEL III is reason enough to exempt community banks from the Proposal.

The Proposal 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.

Additionally, we note that under the current regulatory framework, a bank's primary federal regulator is broadly empowered to require higher capital if it determines that a bank's credit, market, operational, or other risks pose a significant risk to the FDIC insurance fund. This subjective authority is undermined by the BASEL III Proposal which appears to eliminate this regulatory judgment in favor of a formula-driven outcome which does not take into consideration the actual risks that a bank's activities pose to its safety and soundness and the integrity of the FDIC deposit insurance fund. This is becoming more evident everyday with the emphasis on stress testing and formula-driven oversight, which is replacing the reliance on comprehensive bank examinations.

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[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.

Using a formula-driven oversight process in determining capital adequacy is a huge mistake because the qualitative results of a properly-executed onsite examination are far more reliable indicators of a bank's financial condition than some computer model.

Evidently, the bank regulators believe the BASEL III capital requirements must be applied to community banks due to the Collins Amendment of Dodd-Frank because it implies that all depository institutions be subject to the same generally applicable capital and leverage standards. It is hard to believe that Congress intended to apply the highly-complex BASEL III capital rules crafted for global banks to community banks.

As evidence that Congress had no such intention, it should be noted that in a comment letter dated September 27, 2012, submitted by 53 Senators, they urge the regulators to "consider the impact that applying standards developed for large, complex institutions will have on the unique and vital role that community banks play within the U.S. financial system." They further state that "the complexity of new global rules adds little value to the community institutions which your agencies rigorously regulate and monitor."

C. Capital Volatility Due to Unrealized Gains and Losses Being Included in the Accumulated Other Comprehensive Income Component of Common Equity Tier 1 and Capital Buffer Requirement

IBC strongly objects to the inclusion of unrealized gains and losses on securities available-for-sale ("AFS Securities") in the Accumulated Other Comprehensive Income component of Common Equity Tier 1 Capital ("CET1"). This will introduce unnecessary and significant volatility into the capital calculations. Gains and losses on AFS portfolios occur primarily as a result of interest rate movements as opposed to changes in credit risk. Interest rates in debt securities can fluctuate frequently, often daily. With interest rates at the lowest levels in several decades, at some point the interest rate levels will be higher. Banks will be forced to hold more capital to compensate for inevitable swings in interest rates, not swings related to the performance of the securities.

Capital is supposed to provide a cushion to protect against the ups and downs of the markets; it is not suppose to create capital volatility by amplifying swings related to interest rates.

With the very significant erosion of earnings streams of community banks resulting from the reduction of income from interchange fees and overdraft fees, reduced loan demand, and the increased costs related to the Dodd-Frank regulatory burden, community banks are desperately searching for earning assets. The volatile impact on capital related to interest rate swings on AFS Securities will discourage banks from investing in AFS Securities that could be quite attractive from an earnings perspective.

The IBC experience demonstrates that the inclusion of the unrealized gains and losses is truly ill-conceived. IBC has gone through a number of cycles when its bond portfolio was underwater, but the income from the bonds was producing exceptional returns and ultimately the market turned and IBC also experienced significant gains on the bond portfolio.

If IBC had been subjected to the BASEL III capital rules at that time, IBC would have needed to reduce the exposure from the additional capital required due to volatility related to the bonds and this would have seriously reduced the returns on the securities even though the bonds were performing very well from an earnings perspective.

In the Proposal's preamble, the Agencies acknowledge that temporary changes in the market values of certain lower-risk debt securities could introduce substantial volatility to regulatory capital ratios, in some cases triggering prompt corrective action ("PCA") enforcement actions.

The risk of a PCA related to capital swings created by the impact of interest rate changes on AFS Securities will simply mean that community banks will carry excess capital in order to avoid inadvertently falling below adequate capital levels due to these potential volatile capital swings. This inflated capital level will become the norm because the peers of a community bank will also increase their capital levels due to these concerns. The collective impact of the unnecessarily inflated capital levels of the community bank industry will not make the industry any safer, but it will result in higher credit costs for customers of the banks. To the extent community banks must raise capital to meet the inflated capital levels, it is important to note that raising capital for community banks can be very challenging. Even with the provisions of the Jobs Act, signed into law on April 5, 2012, that were adopted to attempt to facilitate capital raises of smaller companies and community banks, in many instances there may be little or no demand for the stock of a privately-held community bank. IBC as a publicly-traded financial holding company would have more ability to raise capital than privately-held community banks; but even for a publicly-traded company raising such additional capital can be unreasonably dilutive to existing shareholders. With the community banks bloated with excess, unemployed capital, the local communities will suffer as the availability of credit is reduced and the credit costs increase. These excessive levels of capital will drive down Return on Equity ("ROE"), making community banks even less attractive as investments, further detracting from their ability to survive. Higher capital levels have already diminished the ROE's of most community banks.

For the following reasons, we oppose the proposal to recognize in CET1 capital unrealized gains and losses on all AFS securities. First, we believe the financial statements and disclosures of U.S. banking organizations already adequately reflect the risks arising from AFS securities. Second, the community bank model largely focuses on the spread between earning assets and funding liabilities, not total return.

This will cause banks to shorten their duration to avoid market volatility which will drive down interest income, further damaging revenues needed to sustain profitability. This fair value focus of BASEL III is completely inconsistent with the community bank model and could affect the safety and soundness of the community bank industry.

Based on the foregoing, we strongly urge the Agencies to reject as unsafe and unsound the requirement to include unrealized gains and losses on AFS securities in regulatory capital.

Given the ill-conceived basis of these provisions and their overwhelmingly negative consequences, the most prudent course of action for the Agencies is to avoid any temporary volatility in regulatory capital of community banks. Tweaks to this aspect of the Proposal related to AFS Securities, such as the outright exemption of gains and losses on U.S. government and GSE securities, or the bifurcation and exemption of interest-rate-related losses from all securities, are not sufficient. The only prudent solution is to exclude all unrealized gains and losses from regulatory capital related to community banks.

IBC also opposes the additional 2.5% capital buffer to be applied to the common equity ratio, the tier 1 capital ratio, and the total capital ratio that must be met with common equity capital. IBC completely respects the need for sufficient capital for community banks, but IBC believes the current capital regulations related to community banks are sufficient and that the capital buffer for community banks is too confusing and unnecessary. The fact that failure to meet the additional capital buffer would result in limits on cash dividends and discretionary bonuses evidences that this aspect of the Proposal was directed at the largest banks because it is not very relevant to community banks that often have very simple and conservative compensation structures.

The existing capital regulations applicable to community banks are effective and do not need to be changed. This is especially true in view of the important role of the bank examiners with respect to community bank capital matters.

Any capital nuances that are necessary for a specific community bank may currently be addressed between the bank and its primary regulators. Also the role of the loan loss reserve should not be overlooked in determining adequate capital levels. Applying the global BASEL III capital rules to community banks will not improve the regulation of capital levels of community banks.

D. Risk Weighting of High Volatility Commercial Real Estate and Mortgage Loans

With certain exceptions, the proposal defines "High Volatility Commercial Real Estate" ("HVCRE") as acquisition, development and construction ("ADC") commercial real estate loans. Under the Proposal, HVCRE loans are assigned a 150% risk weight, while current risk weighting is 100%. IBC objects to the higher risk weighting for commercial real estate lending because it is unwarranted and will unnecessarily limit credit availability and raise costs for community bank borrowers and slow economic recovery in the Texas and Oklahoma markets served by the IBC subsidiary banks. The IBC subsidiary banks, like most community banks, are relationship lenders who know their commercial customers and have a firm understanding of the local economies because management lives and is active in those communities. The IBC motto is "We Do More" and that applies to the way IBC treats its customers as well as the way IBC supports the communities IBC serves.

Also, the nature of relationship banking is that IBC often provides essentially all of the banking services to many of its commercial customers. Relationship banking places a greater emphasis on long-term customer relationships, incorporating soft information that is not easily quantifiable.

This type of customer relationship allows IBC to minimize credit risk with credit enhancements that are not factored into the risk weighting under the Proposal. IBC also objects to the retroactive application of the Proposal. Rather than only applying to new loans, the Proposal would apply to the existing loan portfolio of the bank. As a result, community banks may need to adjust their capital based on their existing portfolio and many community banks may have difficulty raising the additional capital. The Proposal does not take into account the smaller risk component of CRE loans that have a LTV well below 80%, have shorter terms and are performing. These types of loans are more prevalent in community banks that structure the loans based on long-standing relationships with the borrowers. This is another key example of why the Proposal should not be applied to community banks.

The Proposal makes no changes to the capital treatment of mortgage loans guaranteed by the U.S. government or an agency of the U.S. government. Loans that are unconditionally guaranteed would retain a risk weighting of zero, while loans that are conditionally guaranteed will retain a risk weighting of 20%. However, for loans that are not guaranteed by the U.S. government or a U.S. government agency, risk weightings will change from a uniform 50% to anywhere from 35% to 200%, with the lower risk weightings available only to mortgage loans that conform to narrow regulatory criteria. Risk weightings, and therefore capital requirements, increase with an increased loan-to-value ratio. Residential mortgage loans that conform to narrow regulatory criteria, including senior lien status, maximum thirty-year term, no deferrals and no negative amortization, are classified as "category 1." All other residential mortgage loans are classified as "category 2." The effect of this is that mortgage loans that do not conform to category 1 underwriting criteria will require at least twice as much capital as those that conform. For example, under the standardized approach, a loan with a 20% loan-to-value ratio that does not conform to the category 1 criteria would require twice as much capital as a loan with an 80% loan-to-value ratio that conforms to the category 1 criteria. Surprisingly, the presence of private mortgage insurance is not considered in determining the risk weighting percentage, regardless of the loan-to-value ratio. This may put a damper on many first-time homebuyers and other programs that incorporate private mortgage insurance as a key component, thereby negating this country's current and fragile housing recovery. We believe that the proposed risk weights for Category 2 mortgage loans should be lowered considerably.

Even if a loan meets the criteria for a category 1 loan, the primary federal regulator for a bank may nevertheless determine that the loan is not prudently underwritten and require that the loan be treated as category 2. Unfortunately, it is a one way street: a category 1 loan can be deemed category 2, but a category 2 loan, no matter how little risk it presents, can never be deemed category 1. This may give bank examiners increased authority to unilaterally require increased capital at individual banks based upon underwriting practices; but will not provide any discretion to allow lower levels of capital for low-risk loans that do not fit category 1 criteria.

We are also very concerned about the potential fair lending implications related to the proposed higher capital requirements for category 2 mortgage loans. In particular, if the market significantly decreases for such loans because banks cease to hold them for investment, will the fair lending advocates at the federal banking agencies and the U.S. Department of Justice conduct disparate impact investigations and even worse, bring enforcement actions against community banks? This would be most unfair as the community banks would have a justifiable business reason for not making and holding these mortgage loans.

The Proposal's new risk-weighting of community bank loan assets (e.g., mortgage loans and HVCRE), will increase regulatory burden and combined with the pressures for additional capital will serve to further make the community bank business model unattractive for current or potential investors. This will make it more difficult for community banks to raise capital and more likely that community banks will be forced to consolidate in order to manage the combined effect of the significantly increased compliance and legal costs and the reduction of revenue streams and the increased pressure on capital levels.

E. Trust Preferred Securities.

The BASEL III Proposal takes a more conservative approach than Dodd-Frank to eliminate trust preferred securities ("TPS") as a form of tier 1 capital. Contrary to the Collins Amendment that grandfathered tier 1 capital status for all bank holding companies with total assets less than $15 billion as of December 31, 2009, the Proposals will begin amortizing down the tier 1 capital treatment of TPS over 10 years beginning in 2013 with full phase-out occurring on January 1, 2022.[6] IBC does have less than $15 billion in total assets so this change of the grandfathering of the TPS would impact IBC. IBC has approximately $190 million of outstanding TPS and none of these securities will mature before January 1, 2022. While IBC is a well-capitalized financial holding company that has no reason to believe this change in the capital treatment of TPS will impair IBC's ability to maintain well-capitalized levels, this change in the capital treatment imposed by the Proposal is wholly unnecessary and conflicts with the Collins Amendment.

We strongly suggest that the Agencies revise the Proposal to be consistent with the Collins Amendment in its treatment of TPS by grandfathering tier 1 capital status for all bank holding companies with total assets of less than $15 billion. The change in treatment does not make sense. Many trust preferred securities are floating rate and thus represent an extremely cost-effective source of capital in the current historically low rate environment.

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

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 minority areas.

[6] Excluding small bank holding companies with total assets of less than $500 million as of December 31, 2009.

IBC is particularly concerned about this disparate impact because IBC is the largest minority-owned bank in the continental United States. Low-to-moderate minority communities generally have fewer alternatives for banking services and products. We note that the FDIC recently released the results of its 2011 National Survey of Unbanked and Under-banked Households which revealed that more than one in four U.S. households (28.3%), are either unbanked or under-banked.[7] 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 acting 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 proposed 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 the Proposal 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 the Proposal.

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.

G. Conclusion: 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. The Proposal makes sense in the context of a systemically important financial institution ("SIFI"), but it does not make sense for community banks.[8] Community banks are not equipped to adjust to the Proposal's requirements. Community banks should not be subject to the Proposal's new capital requirements because community banks focus on much smaller communities and do not transact business on a global scale. To apply the Proposal 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.

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

[8] 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.

There is a sense that a key purpose of the Proposal is to serve in part as a component of the effort to fix the problems embodied by the economic crisis, a crisis created by the SIFIs. We note that Federal Reserve Governor Daniel K. Tarullo in a statement issued after the June 7, 2012 open meeting of the Board of Governors of the Federal Reserve System when the Proposal was first announced, stated that, "Uncertainty about the capital positions of large financial firms was a major factor in the turmoil that beset the country in the fall of 2008. Subsequent increases in capital at our major banks, along with the information provided by the stress tests in 2009, were important factors in stabilizing the system."[9] Federal Reserve Governor Tarullo also stated that, "Strong capital buffers help ensure that losses are borne by shareholders of the bank, not by taxpayers—either directly through some form of bailout, or indirectly through a major negative effect on the economy resulting from the bank's failure.[10]

A common capital standard for the largest banks that compete on a global basis does appear to be a laudable goal. However, recent commentary indicates that the EU is considering a delay of the Rule of up to a year.

Applying the Proposal to community banks in the U.S. when significant uncertainty exists regarding the future viability of the Proposal should be avoided especially in view of the irreparable damage the Proposal could have on community banks.

At a recent meeting of the European Union ministers, there were outspoken critics who expressed opposition to the Proposal covering all 6,000 euro zone banks instead of the top 25 euro zone global banks.[11] That criticism was echoed in the United States when numerous groups expressed their disagreement with the Proposal applying to community banks. "Federal regulators are facing a growing rebellion from bankers, lawmakers and now even fellow supervisors over a proposal to implement Basel III."[12]

Recent 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 the Proposal.[13] This finding does not weigh in favor of the Proposal being applied to community banks. It heavily weighs against it. It proves that the Proposal is not necessary for community banks. The costs, volatility and complexities of the Proposal 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?

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[9] http://www.federalreserve.gov/newsevents/press/bcreg/20120607a.htm and at http://222.federalreserve.gov/20120607openmaterials.htm.

[10] Id.

[11] BNA Banking Law Report, "EU Plan Triggers Political Backlash, Doubts Raised About 2012 Start Date", Page 495, September 25, 2012.

[12] American Banker, by Donna Borak, October 4, 2012.

[13] Id.

The aggregate burden of the Proposal'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. The Proposal's capital requirements threaten the future viability of community 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.[14] 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.

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."[15] 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.

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

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

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 new book, "Bull by the Horns" where she describes the great lengths taken to rescue the nation's top banks at all cost during the economic crisis while community banks failed and consumers suffered.[16] The consideration of the Proposal 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 than is contained in the Proposal.[17] Unfortunately, the debate failed to address the rationale and impact of applying the Proposal to community banks. If it had, the regulators would have realized the Proposal should not be applied to community banks.

The banking regulators 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 Proposal already distinguishes between the global banks and community banks in certain respects. The regulators should extend that distinction to the entirety of BASEL III and exempt community banks and regional bank holding companies completely from the impact of the Proposal.

Respectfully,

Dennis E. Nixon
President and CEO

[16] The Washington Post, by Zoehang A. Goldfarb and Brady Dennis, September 25, 2012.
[17] American Banker, by Donna Borak, September 26, 2012.