International Bancshares Corporation

September 24, 2013

Via email Rulemaking Portal: www.regulations.gov

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 205551

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

Re: Board: Docket No. OP-1461, Proposed Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations with Total consolidated Assets of more than $10 Billion but less than $50 Billion; FDIC: Stress Test Guidance.

Gentlemen:

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 serving Texas and Oklahoma with each bank having less than $10 billion in assets. With $11.6 billion in total consolidated assets, IBC is the largest Hispanic-owned financial holding company in the continental United States. IBC is a publicly-traded financial holding company. We appreciate the opportunity to comment on this proposal.

In October 2012, the agencies issued final rules implementing stress testing requirements for companies) with over $10 billion in total assets pursuant to section 165(1)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA stress test rules"). On August 5, 2013, the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation ("FDIC"), and other Federal bank agencies (collectively, the "Agencies"), issued proposed supervisory stress test guidance ("Proposed Guidance"), which would apply to all banks and bank holding companies, with total consolidated assets of more than $10 billion but less than $50 billion ("Mid-Sized Banking Organizations"). The consolidated assets of IBC exceed $10 billion, but none of the subsidiary banks of IBC have total assets with more than $10 billion. The Proposed Guidance builds upon the interagency stress testing guidance issued in May 2012 for companies with more than $10 billion in total consolidated assets.

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The Proposed Guidance describes high-level principles that should be used by Mid-Sized Banking Organizations to implement the stress tests such organizations in order to comply with the DFA stress test rules. In the Proposed Guidance, the Agencies emphasize the importance of stress testing to Mid-Sized Banking Organizations as an ongoing risk management practice "that supports a company's forward-looking assessment of its risks and better equips the company to address a range of macroeconomic and financial outcomes." The Proposed Guidance describes the Agencies' supervisory expectations of Mid-Sized Banking Organizations and the methodologies that such companies should use in conducting annual stress tests.

Under the DFA stress test rules, Mid-Sized Banking Organizations must assess the potential impact of a minimum of three macroeconomic scenarios: (1) baseline, (2) adverse and (3) severely adverse on the Mid-Sized Banking Organization's consolidated losses,[1] revenues,[2] balance sheet (including risk-weighted assets) and capital.[3] The Proposed Guidance states that each scenario should be analyzed across all business lines and on the enterprise as a whole. The Agencies will provide a description of the supervisory scenarios to banking organizations no later than November 15 of each calendar year. The Agencies believe that a uniform set of supervisory scenarios is necessary to provide a basis for comparison across companies; however, a banking organization is not required to use all of the variables provided in the scenario if those variables are not relevant to the institution.

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[1] The Proposed Guidance provides that in conducting a stress test, for each quarter of the planning horizon, a company must estimate the following for each required scenario: losses, pre-provision net revenue ("PPNR"), provision for loan and lease losses ("PLLL"), and net income. Credit losses associated with loan portfolios and securities holdings should be estimated directly and separately, whereas other types of losses should be incorporated into estimated pre-provision net revenue.

[2] The Proposed Guidance indicates that companies that are less complex or less sophisticated could estimate projected PPNR based on the three main components of PPNR (net interest income, non-interest income, non-interest expense) at an aggregate, company-wide level based on industry experience. In addition to credit losses, companies may determine that other types of losses could arise under the supervisory scenarios. These other types of losses should be included in projections of PPNR to the extent they would arise under the specified scenario conditions.

[3] Under the Proposed Guidance, a company would be expected to ensure that projected balance sheet and risk-weighted assets remain consistent with regulatory and accounting changes, are applied consistently across the company, and are consistent with the scenario and the company's past history of managing through different business environments. Companies are required to document and explain key underlying assumptions about changes in balances or risk-weighted assets under stressful conditions, including justifying major changes, justifying any assumptions about strategies that may mitigate losses under the stressful conditions, and ensuring that the assumptions do not substantially alter the company's core businesses and earnings capacity.

The Proposed Guidance states that Mid-Sized Banking Organizations are allowed flexibility in determining the methodologies they choose to use in conducting stress tests and that a Mid-Sized Banking Organization is expected to choose practices and methodologies that are appropriate for its risk profile, size, complexity, business risk, market foot-print and the materiality of specific portfolios of assets. With respect to governance, controls, oversight and related documentation, the Proposed Guidance notes that the Agencies expect that Mid-Sized Banking Organizations will consider the results of stress testing in the respective company's capital planning, assessment of capital adequacy, and risk management practices.

I. Comments

A. National Variables in Supervisory Scenarios

In the Proposed Guidance, the Agencies invited comment on all aspects of the proposed guidance. Specifically, the Agencies sought comment on five questions.

In Question #1, the Agencies specifically ask what challenges do companies expect in relating the national variables in the scenarios to regional and local market footprints?

The Proposed Guidance indicates Mid-Sized Banking Organizations should apply each scenario across all business lines and risk areas so that they can assess the effect of a common scenario on the entire enterprise, though the effect of the given scenario on different business lines and risk areas may vary. These companies may use all or, as appropriate, a subset of the variables from the supervisory scenarios to conduct a stress test, depending on whether the variables are relevant or appropriate to the company's line of business. The companies may, but are not required to, include additional variables or additional quarters to improve their company-run stress tests. For example, the Proposed Guidance includes a set of questions on translating supervisory scenarios to regional variables and minimum expectations for loss estimation. *However, the paths of any additional regional or local variables that a company uses would be expected to be consistent with the path of the national variables in the supervisory scenarios.*

We are concerned with the "one size fits all" approach of the DFA stress test rules and the Proposed Guidance, particularly the requirement that the variables chosen by banks be from the Agencies' supervisory scenarios and that they be consistent with the path of national variables. The regulators and a bank should mutually determine the stress testing criteria to avoid the distortions that a "one size fits all" approach would create. Furthermore, allowing the Agencies to unilaterally set the parameters of all stress test supervisory scenarios seems counterintuitive at best, based on the bank regulators' past performance in predicting economic booms or busts, the rate of economic growth or the level of prices or exchange rates. It is critically important that these stress tests be designed in close collaboration with the bank being subjected to the test. The stress tests should be carefully modeled to include all the relevant risks or the reliance on the stress tests could be even more dangerous because the foundation of the tests was incomplete. Risk management is more art than science.

Furthermore, we strongly urge the Agencies to adopt specific stress test requirements, including scenarios, that are commensurate with each individual bank's size, complexity, geographic location and business profile, and to not utilize stress test requirements that are far-fetched or overly complex. The stress test scenarios for the Mid-Sized Banking Organizations should not be as complicated as they are for the systematically important financial institutions ("SIFIs"). The regional and community banks, unlike the SIFIs, do not present any systemic risk to this country's financial system. There is a real danger that "one-size fits all" scenarios will take the place of tailored stress testing efforts. Tailored efforts are useful to a banking organization because they consider the organization's unique factors. Different geographic regions of the country respond differently to economic and financial developments because each region is different. For example, Texas, unlike other parts of the country, did not experience a housing bubble leading up to the 2008 financial crisis. Thus, single family home prices did not significantly decline in Texas and in the areas where prices did decline, the declines were modest. These regional differences can be enormous and varied and they affect banks considerably.

It should also be noted that state law differences can have a significant effect on the performance of certain assets. As an example, one of those differences is home equity lending. In Texas, home equity lending is tightly controlled by state law prohibiting, as an example, a lender advance of more than 80% of the value of a home. Where in most states that advance rate can go well beyond 100% of the value of the home. Stress testing these categories of loans should result in significantly different outcomes. Other laws that govern lending can also determine how the losses on lending can be mitigated or increased. An example of that difference would be the difference between the requirement to go through a statutory foreclosure versus a trustee sale that is available in Texas. In Texas a lender can secure control of the asset securing the loan much faster thereby reducing the losses that may occur from a protracted foreclosure process. This also affects other types of lending as well such as purchase money second lien lending on homesteads. Since the markets across the country can vary so much, second mortgage lending can perform much differently in different markets. In Texas, our second lien portfolio never experienced any significant losses during the crisis. In fact, it performed as well as or in some cases even better than our first mortgage portfolio, which performed extremely well throughout the crisis. So these local differences can be significant and must be accounted for to achieve the proper results from a stress test. Finally, community banks tend to lend more based on relationships than do the larger banks. Because of this, these relationship loans tend to perform much better than loans generated in volume using scale to develop a bank's loan portfolio. Most community banks operate on a loan by loan basis where the larger institutions tend to operate on a much larger scale and tend to generate volumes of loans based on a more cookie cutter format. Those loans can more easily be stress tested than an individually underwritten loan based on a relationship. A relationship loan will generally perform significantly better in a crisis than a cookie cutter credit where there is not any particular attachment to the lending institution. Stress testing for community banks has limited value. The full scope bank examination should be the primary basis of determination of the asset quality of a community bank.

For purposes of determining a banking organization's condition, stress testing cannot be a substitute for the examination process which is already extensive. Banks are unique enterprises and require human interaction through the examination process to accurately determine the actual condition of a bank. This is especially true for community banks where customers are connected to the bank through individual relationships with their bankers. The intangibles of these relationships in many cases are more important than the data profile of the customer. Remember, lending is more art than science which stress testing cannot measure.

Finally, we also strongly urge the Agencies to ensure that all the events in the stress testing scenarios be coherent, plausible, and logical. Stress testing is a tool for bank management and the board of directors to use to assess, and ultimately, to manage risk. The more extreme and unrealistic a scenario is, the less useful it is as a management tool. A "break the bank" scenario would produce speculation of questionable value to bank management and certainly not be useful in a public forum. The relationship knowledge of community bankers in many cases is more important than the raw data.

B. Data Sources and Segmentation

In Question #2, the Agencies also specifically ask what additional clarity might be needed regarding the appropriate use of historical experience in the loss, revenue, balance sheet, and risk-weighted asset estimation?

The use of historical experience in the loss, revenue, balance sheet and risk-weighted asset estimation would add an additional degree of clarity to the stress testing process, but the ability of the Mid-Sized Banking Organizations to compile that level of data is limited. In conducting a stress test, the Proposed Guidance provides that a banking organization should segment its portfolios and business activities into categories based on common or related risk characteristics and should select the appropriate level of segmentation based on the size, materiality, and riskiness of a given portfolio, *provided* there are sufficiently granular historical data available to allow for the desired segmentation. A company would be expected to be able to segment its data at a level at least as granular as the reporting form it uses to report the results to its primary regulator and the Board, but may use a more granular segmentation, particularly for more material or riskier portfolios. If a company does not currently have sufficient internal data to conduct a stress test, it may use an alternative data source as a proxy for its own risk profile and exposures. However, companies with limited data would be expected to construct strategies to develop sufficient data to improve their stress test estimation processes over time.

The Proposed Guidance's requirements that the Mid-Sized Banking Organizations accumulate more data and undergo extra layers of regulatory analysis, oversight, and controls, will merely increase the compliance costs of regional and community banking organizations. Most regional and community banks do not have the financial resources and time to develop internal systems, including the hiring of additional personnel capable of conducting the new stress tests. In fact, the availability of such personnel is doubtful since many institutions may be located in smaller cities or more rural areas.

Furthermore, most Mid-Sized Banking Organizations do not have sophisticated information technology systems with robust data fields comprehensively maintained to obtain the financial data required to conduct the proposed stress tests.

Regional and community banking organizations will be required to rely on outside, third party service providers to perform the analysis, which will further increase already high compliance costs. We believe that the DFA stress test process will impose additional staffing and operational costs on the already over-burdened U.S. banking industry. The banking industry is currently struggling to comply with the numerous and complex Dodd-Frank Act mandated regulations, many of which have not yet been promulgated by the federal agencies. Regional and community banking organizations already have strong risk management programs and are already subject to a robust system of financial regulation and examination. Additionally, unlike SIFIs that have complex structures and are engaged in complicated international transactions, they generally have simple structures and are engaged in plain vanilla banking services. Their operations tend to be simple and straightforward and relationship driven. These stress tests for the Mid-Sized Banking Organizations will create complexity where complexity does not exist and is not warranted. The cost of dealing with the stress tests requirements will unduly burden the Mid-Sized Banking Organizations. At our institution, just preparing for the stress testing, IBC has spent $300,000 on outsourcing and hundreds of hours preparing for the stress tests. It is clearly counterproductive to be expending massive resources to add another level of review when the bank is thoroughly examined annually in a very comprehensive way. It appears that this stress exercise is duplicative and will add very little value as the safety and soundness exam is extremely comprehensive. The duplication just adds huge cost to the bank and becomes an escape mechanism for the regulators.

C. Use of Vendors or Other Third-Party Products

In Question #3, the Agencies specifically ask what additional clarity should the Proposed Guidance provide about the use of vendor or other third-party products and services that companies might choose to employ for DFA stress tests?

As previously noted, the utilization of third party service providers by Mid-Sized Banking Organizations to perform the analysis will further increase already high compliance costs. The SIFIs have vast resources (it is our understanding they have been spending millions of dollars to maintain and run these tests) to conduct the proposed stress tests; however, we, and most Mid-Sized Banking Organizations, do not have the large scale to spread high compliance costs over a broad base and are required to bear these costs more disproportionately than the SIFIs.

Based on the undue burden that the DFA stress test rules will place on regional and community banks, we recommend that in the Proposed Guidance, the Agencies give Mid-Sized Banking Organizations ample discretion to select and utilize vendor and other third-party products and services as long as the banks, with the help of the third parties, conduct their stress tests in accordance with the DFA stress test rules and existing supervisory guidance. Banking organizations already outsource a myriad of functions to third parties.

The bank regulators have developed an adequate vetting process for the use of third party providers and this vetting process should suffice for the stress testing services. We cannot understate how oppressive these requirements have become, and the fact that many smaller institutions will be required to use outside resources just adds huge cost to each entity. With a full scope examination, we believe that stress tests should be targeted to asset classes that respond well to stress tests such as the bank's securities or credit card portfolios. With the continual need to produce stress tests, outside resources will likely be an ongoing necessity and the cost associated will be forever embedded in the banks' overhead.

D. Capital Action Assumptions for Banks and Holding Companies

In Question #4, the Agencies specifically ask how could the Proposed Guidance be clearer about the manner in which the required capital action assumptions between holding companies and banks differ, and how those different assumptions should be reconciled within a consolidated organization?

In their DFA stress tests, bank holding companies are required to calculate pro forma capital ratios using a set of capital action assumptions based on historical distributions, contracted payments, and a general assumption of no redemptions, repurchases, or issuances of capital instruments. While holding companies are required to use specified capital action assumptions, there are no specified capital action assumptions for banks. The Proposed Guidance provides that a bank should use capital actions that are consistent with the scenarios and the company's internal practices in their DFA stress tests. For banks, projections of dividends that represent a significant change from practice in recent quarters (*e.g.*, to conserve capital in a stress scenario), should be evaluated in the context of corporate restrictions and board decisions in historical stress periods).

Additionally, the Proposed Guidance provides that a holding company should consider that it is required to use certain capital assumptions that may not be the same as the assumptions used by its bank subsidiaries. Any assumptions about mergers or acquisitions, and other strategic actions should be well documented and should be consistent with past practices of management and the board during stressed economic periods. The Proposed Guidance provides that should the stress test submissions for the bank and its holding company differ in terms of projected capital actions (*e.g.*, different dividend payout assumptions during the stress test horizon for the bank versus the holding company) as a result of the different requirements of the DFA stress test rules, the institution should address such differences in the narrative portion of their submissions.

We agree with the flexibility that the Proposed Guidance affords. We believe the capital action assumptions, including how different assumptions between a holding company and a bank should be reconciled within a consolidated organization, provide institutions with helpful flexibility; however, for small and medium size holding companies these rules are creating complexity where complexity does not exist. Many smaller holding companies are very simply organized, managed and operated and maintain significantly larger capital ratios than the very large companies.

These requirements create excessive burden when a nickel pencil and a yellow pad are all that is needed to forecast the capital ratios. These rules continue to create complexity that many of these small to medium size holding companies work to avoid. This continues to be a huge problem for the community banking system. The introduction of complex rules on simple and uncomplicated institutions should be avoided.

E. Corporate Governance

In Question #5, the Agencies specifically ask what additional clarification would be helpful to companies about the responsibilities of their boards and senior management with regard to DFA stress tests?

Under the DFA stress test rules, a Mid-Sized Banking Organization is required to establish and maintain a system of controls, oversight, and documentation, including policies and procedures, that are designed to ensure that its stress testing processes are effective in meeting the requirements of the DFA stress test rule. The Proposed Guidance describes supervisory expectations and sound practices regarding the controls, oversight, and documentation required by the rule. All Mid-Sized Banking Organizations must consider the role of stress testing results in normal business including in the capital planning, assessment of capital adequacy, and risk management practices of the company. For instance, a Mid-Sized Banking Organization would be expected to ensure that its post-stress capital results are aligned with its internal capital goals and risk appetite. For cases in which post-stress capital results are not aligned with a company's internal capital goals, senior management should provide options it and the board would consider to bring them into alignment.

We are concerned that the Agencies may utilize the foregoing requirements to unnecessarily require Mid-Sized Banking Organizations to vary the level and composition of capital or even the future course of the banking organization. There is a strong risk that banking organizations will likely be forced to add expensive capital as a result of exaggerated stress testing scenarios that do not take into consideration each organization's actual structure and the peculiarities of its market and geographic location or just the simple nature of the organization. This could result in diluted shareholder earnings, or the impairment of the banking organization's ability to pay cash dividends because of a perceived material capital deficiency created by the stress test. Under the BASEL III rules, banking organizations will already be required to maintain enhanced levels of capital. It is very troubling that banking organizations may be required to add additional capital due to the hypothetical need for capital based on unrealistic stress test scenarios that are not adequately tailored to the banking organization, or realistic based on past experience. For example, the FDIC requires a 400 basis point instant shock for increased interest rates. No time in history has that occurred.

Successful financial institutions, especially those that are publically-traded, already manage risk based on the standards contained in the DFA stress test rules. Bank management is generally better able than regulators to know and judge the peculiarities and complexities associated with its organization, the nature of the institution's operations and assets, and its geographic location.

Conversely, bank regulators must be familiar with banks across a broad geographic area with very different customer and product bases. We also note that regulators already have ample authority to restrict unsafe and unsound banking practices. Uniform stress test scenarios present a "one-size" fits all mentality that may actually discourage innovation in the banking industry. A "regulator preferred" lower risk profile could destroy earnings and ultimately destroy a bank. Heavy reliance on risk stress tests by regulators will eventually cause bank management to "run the bank to the test." In particular, banks will be forced to increase their capital levels in order to "appear as safe as" their major competitors. That could result in significant risk adverse decisions being made which would tend to reduce lending and investing causing under-performance by the banking organization. The collective impact of the stress test game-changing mindset could be disastrous for our national economy. Over time it will likely alter the course of bank risk taking which will, in turn, cause loss of economic growth in the nation and destruction of job creation.

Accordingly, we recommend that the Agencies' Proposed Guidance recognize and specifically state that not all stress test results require management of banking organizations to prepare action plans to enhance the level and composition of capital, but instead, recognize that the stress testing will be one factor, among many relevant factors, in assessing the adequacy of a banking organization's capital levels . Stress tests may only indicate a possible future event that may never occur. Forcing a bank to operate to your hypothetical disastrous event is just not realistic. A company that has operated successfully through many adverse events should not be forced to add capital based on a hypothetical event when this organization has successfully managed through actual events with lower levels of capital. Historical performance must be used to balance extreme stress testing templates.

F. Public Disclosure of Stress Test Results

Finally, IBC wishes to comment on the public disclosure of stress test results.

The DFA stress test rules require banking organizations to publicly disclose a summary of the stress test results, including both qualitative and quantitative information. IBC urges the Agencies to adequately explain to the public the hypothetical nature of these stress test results. Unlike the SIFIs, the Mid-Size Banking Organizations do not have the resources to adequately combat misinformation and confusion that is likely to arise in the wake of the reporting of the stress test results.

The stress test results of the Mid-Sized Banking Organizations will likely provide attractive fodder for short traders to use to attack these organizations. The Mid-Sized Banking Organizations are particularly vulnerable to short trader abuses because they do not have as much analyst coverage and they have more limited access to the capital markets than the SIFIs. The ability of the Mid-Sized Banking Organizations to explain or counter the stress test results will be very limited. The banking organizations are prohibited from disclosing their CAMELS ratings so this important rating information will not be available to counter the negative rhetoric created by the disclosure of the stress tests results. Also, publicly-traded companies are very limited in their use of forward looking information under applicable securities laws.

Accordingly, the Mid-Size Banking Organizations would not be able to assuage concerns raised by the stress tests results with favorable forecasts of future performance. We urge the Agencies to adequately explain to the public the hypothetical nature of the stress test results of the Mid-Sized Banking Organizations before any of the results are publicly disclosed.

Thank you for your consideration of our comments.

Respectfully,

Dennis E. Nixon
President