INTERNATIONAL BANCSHARES
CORPORATION

January 22, 2018

Via email Rulemaking Portal: www.regulations.gov

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Docket No. OP-1586 – 12 CFR Part II – Enhanced Disclosure of the Models Used in the Federal Reserve's Supervisory Stress Test; Board of Governors of the Federal Reserve System ("Federal Reserve")

Ladies and 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 five state nonmember banks serving Texas and Oklahoma. With approximately $12 billion in total consolidated assets, IBC is one of the largest independent commercial bank holding companies headquartered in Texas. IBC is a publicly-traded holding company. The Federal Reserve's stress test proposal is very important to IBC and its five subsidiary banks as it has, similar to other banking organizations, experienced significant compliance burdens relating to preparing for its implementation and on-going maintenance, along with the overwhelming issue of other new and costly regulations as a result of passage of the Dodd-Frank Act in 2010. We appreciate the opportunity to comment on the Federal Reserve's proposal.

On December 7, 2017, the Federal Reserve issued three proposals intended to increase the transparency, counter-cyclicality, and risk coverage of its stress testing program applied to U.S. bank holding companies. More particularly, among other things, the Federal Reserve's proposal:

- Proposed a Stress Testing Policy Statement that would describe the Federal Reserve's principles, policies, and procedures guiding the development, implementation and validation of models used in supervisory stress tests, thereby improving transparency surrounding its model development process;

- Proposed three enhancements to the supervisory stress test model disclosures, addressing disclosure of: (i) enhanced descriptions of supervisory models; (ii) modeled loss rates on loans grouped by important risk characteristics and summary statistics associated with the loans in each group; and (iii) portfolios of hypothetical loans and the estimated loss rates associated with the loans in each portfolio; and

- Proposed to modify its framework for the design of the annual hypothetical economic scenarios. The modifications aim to enhance transparency and to further promote the resilience of the banking system throughout the economic cycle. In particular, the revisions include more information on the hypothetical path of house prices as well as notice that the Board is exploring the addition of variables to test for funding risks in the hypothetical scenarios.

This letter summarizes IBC's responses to the Federal Reserve's proposals.

General Support for Federal Reserve's Proposal

We support the Federal Reserve's proposal which seeks to provide greater transparency to banking organizations subject to its stress tests. The Federal Reserve's Proposal would release greater information about the models the Federal Reserve uses to estimate the hypothetical losses in the stress tests. Together, this information would provide significantly more detail as to how the Board's models treat different types of loans under stress, and provide insight into how the annual stress test results are determined. However, as noted below, we have other comments and concerns regarding the Federal Reserve's stress tests.

The April 2017 white paper, "Stress Testing: More Focused Tests for Better Supervision and Management," prepared by the American Bankers Association ("ABA") criticized the current Comprehensive Capital Analysis and Review ("CCAR") stress testing program as impeding sound capital management. Specifically, the ABA's white paper noted that inadequate transparency creates high levels of management uncertainty and structural complexity, and impedes the capital allocation process. Banks must manage, price and allocate capital without a fully informed view of key regulatory drivers and expectations. Efficient capital management is frustrated by unnecessary regulatory mystery. The purpose of bank supervision should be to guide banks in their preparations for risks, rather than to surprise them with unforeseen regulatory expectations. As the ABA noted, "Keeping banks in the dark threatens to convert stress testing into a game rather than an optimally effective safety and soundness tool."

The ABA also criticized the current CCAR stress testing program for being inconsistent with the Administrative Procedures Act ("APA") since they were not subject to the APA's public notice and comment process. Supervisory models and scenarios directly affect how much capital a bank needs to hold for particular assets, as much or more than the Basel capital rules that were adopted following extensive public review and comment. The CCAR program, as currently administered allows the Federal Reserve to pick and choose preferred assets and institutional models at its sole discretion, based on its opinion as to bank performance against hypothetical assumptions of future conditions. The consequences extend beyond the bank to the customers of the bank and can affect the economy more generally.

As to the borrower, banks will tend to shift lending away from sectors that are disfavored by the regulator's supervisory model and scenario assumptions. This can affect credit availability in certain sectors, with meaningful impact on growth and job creation.

We share the ABA's serious concerns regarding stress tests and believe the Federal Reserve should address these concerns.

Reliance on Bank Models

First, the proposal, "Enhanced Disclosure of the Models Used in the Federal Reserve's Supervisory Stress Test", is a move in the right direction towards transparency. However, the reliance of the Federal Reserve's internally developed models within CCAR is the root cause of such transparency concerns. The Federal Reserve's modeling principles apply a one-size-fits-all approach for comparability, which diminishes the accuracy of results. We believe increasing reliance on bank models will connect results to idiosyncratic risk profiles, making for a more robust CCAR process.

Expand Disclosure Beyond Loan-Loss Models

Second, as noted above, the Federal Reserve's proposal for enhanced model disclosure is a move in the right direction. However, the proposal limits the disclosure to loan loss information, leaving a lack of transparency in other stress test components. Enhanced modeling disclosures should be expanded to these other components such as balance sheet assumptions, net interest margin, non-interest income and expense, and operational losses. Expanded disclosure would result in effective feedback between banks and regulators and would allow banks to effectively use stress test results in making risk decisions.

Incorporating Short-Term Wholesale Funding Costs in the Adverse and Severely Adverse Scenarios

Third, the proposal, "Policy Statement on the Scenario Design Framework for Stress Testing", aims to add transparency to the scenario design and provides notice of plans to incorporate wholesale funding costs. However, there is little information provided as to how such funding costs are incorporated into the stress testing framework. For example, there is no information over the types of wholesale funding to be stressed and there is no information over the magnitude and duration of such stress. Given the lack of information, it is not possible to evaluate the inclusion of a wholesale funding shock.

Additionally, IBC believes the Federal Reserve must understand that Federal Home Loan Bank ("FHLB") borrowings have different risk characteristics from other sources of funding that have exhibited stress during adverse economic events. Therefore, banks should be permitted to continue to design their own FHLB borrowings costs under the scenarios.

Elimination of the CCAR Qualitative Objection

Fourth, the proposals do not address the CCAR qualitative assessment, which also lacks transparency. Assessing qualitative issues has been a long-standing practice within supervisory bank examinations. In a 2016 report, the Government Accountability Office stated that the Federal Reserve "has not disclosed information needed to fully understand its assessment approach or the reasons for decisions to object to a company's capital plan.

Transparency is a key feature of accountability and this limited disclosure may hinder understanding of the CCAR program and limit public and market confidence in the program and the extent to which the Federal Reserve can be held accountable for its decisions."[1]

Undue Burden on Regional and Community Banks

Fifth, while we understand that stress tests can provide valuable insight into the strength and resilience of the financial system, we very much question the usefulness of the tests for banks that do not pose systemic risk. For instance, midsize banks, which have modest financial and geographic footprints, are subject to stress tests under macroeconomic scenarios that have little or no relevance to them.

The Dodd-Frank Act's arbitrary asset thresholds of $10 billion, $50 billion and $250 billion crudely divide the industry in a manner that is unrelated to actual risk, and needlessly tie the hands of agencies seeking to strike an appropriate regulatory balance. Most regional and community bank holding companies 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, assuming that the personnel are even available since many banking organizations may be located in smaller cities or more rural areas. The large complex banking organizations have vast resources (it is our understanding they have been spending millions of dollars to maintain and run these tests) to conduct the stress tests; however, we, and most community and regional banks, do not have the scale to spread high compliance costs over a broad base and are required to bear these costs more disproportionately than the large complex banking organizations.

Community and regional bank holding companies are required to rely on outside, third party service providers to perform the analysis, which has further increased already high compliance costs. The stress test requirements have imposed additional staffing and operational costs to the already burdened U.S. banking industry which has struggled to comply with the numerous and complex Dodd-Frank Act mandated regulations being promulgated by federal agencies. Regional and community bank holding companies already have strong risk management programs and are already subject to a strong and robust system of financial regulation. Additionally, unlike large complex banking organizations with over $50 billion in total assets, regional and community bank holding companies do not present undue risk to this country's financial system. Their operations tend to be simple and straightforward. These tests have created complexity where complexity does not exist.

Furthermore, the regional and community bank holding companies already undergo a comprehensive and intense safety and soundness examination by Federal Reserve examiners or other regulatory agencies that thoroughly examine all aspects of the banking organization's operations. Surely, this examination process is a much stronger and thorough process than some mechanical process that uses abstract criteria to gauge the quality of the banking

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[1] U.S. Government Accountability Office. (2016, November), Additional Actions Could Help Ensure the Achievement of Stress Test Goals, Publication No. GAO-17-48, see at https://www.gao.gov/products/GAO-17-48.

organization's operations or assess its risks. Substitution of a hands-on "boots on the ground" process with a mechanical and robotic process flies in the face of reason, and forcing publication of the stress test results is irresponsible. For purposes of determining a banking organization's condition, stress testing cannot be a substitute for the examination process. Midsize bank holding companies are unique enterprises and require human interaction through the examination process to accurately determine the condition of the company.

We strongly urge the Federal Reserve to work with Congress to alleviate the burdens of stress test on midsize banks, including increasing the stress test threshold for banking organizations to $250 billion. Without congressional action, midsize banks will be forced to continue diverting resources into burdensome stress tests that could otherwise be used to serve customers. However, the Federal Reserve can take steps today to ease the burden on midsize banks. As discussed in a July 22, 2016 comment letter, "Midsize Bank Stress Testing Requirements", prepared by the ABA, such steps include limiting and aggregating the disclosure of stress testing results, allowing for a floating submission date, and allowing for the reuse of scenarios over multi-year periods.

Thank you for your consideration.

Respectfully,

Julie Tarvin

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