International Bancshares
Corporation

January 31, 2014

Via E-mail regs.comments@federalreserve.gov

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
10th Street and Constitution Avenue, NW
Washington, DC 20551

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

Re: ***Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring; Federal Reserve Docket No. R-1466; FDIC: RIN 3064.AE04***

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 over $12 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.

On October 24 and 30, 2013, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the "Agencies"), issued a proposed rule that would implement a liquidity requirement in accordance with the liquidity coverage ratio standard established by the Basel Committee on Banking Supervision.

Under the proposed rule, large U.S. banks (banking organizations with $250 billion or more in total assets and subsidiary depository institutions of such internationally active banking organizations with $10 billion or more in total consolidated assets) would be required to do the following two things: (i) calculate on each business day the amounts of its projected liquidity inflows and outflows for the following 30 days and determine the extent to which projected outflows exceed projected inflows (*i.e.*, liquidity coverage ratio ("LCR")); and, (ii) maintain high-quality liquid assets ("HQLA") in an amount sufficient to cover the projected net outflow, subject to a minimum amount of 25 percent of total outflows.

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Under the proposed rule, policies and procedures must govern the determination of HQLA on a daily basis, identify where they are held, and impose other prudential requirements.

For banks with total assets between $50 billion and $250 billion, the period would be only 21 days. Banks with total assets below $50 billion would not be directly subject to the rule. Under the proposed rule, banks would begin the LCR transition period on January 1, 2015, and would be required to be fully compliant by January 1, 2017. The proposed rule's transition period is shorter than that included in the Basel accord which calls for enforcement by January 1, 2019.

The purpose of this comment letter is to address the serious concerns we have with the proposed rule.

I. Undue Burden on Regional and Community Banks

Although none of IBC's subsidiary banks currently have total assets of $10 billion or more, IBC has chosen to comment on the Proposal because all of the subsidiary banks of IBC may be impacted by the proposed rule due to the tendency of bank regulators to apply the spirit of regulations or guidance that apply specifically to larger banking entities to all banking entities. In many recent instances, the bank regulators have evidenced a troubling tendency to apply the regulations that are specifically applicable only for larger banks to smaller banks under the guise that the large bank requirements represent prudent regulatory practices that all banks should follow. This trickle-down mentality is already showing up in recent safety and soundness examinations with requests for more complex stress test modeling. Undoubtedly, there are practical and valid reasons why the rules were *not* intended for the smaller banks in the first place. Instead, the regulators should shield the already over-burdened smaller banks from trickle-down regulations driven by examiners that were intended only for larger banks since the smaller banks lack the resources or sophistication necessary to comply with the large bank regulations.

II. Negative Impact on Capital Markets

A. GNMAs

As previously noted, banks with total assets of $250 billion or more would need to hold enough HQLA to survive a time of stress lasting 30 days. Under the proposed rule, for an asset to qualify as HQLA, it must be liquid and readily marketable, a reliable source of funding in repo or sales markets, and not an obligation of a financial company.

As is done under the Basel Committee's LCR framework, the proposed rule divides HQLA into three categories of assets: Level 1 (very high quality and highly liquid assets), Level 2A (include certain claims on, or claims guaranteed by, a U.S. government–sponsored enterprise and certain claims on, or claims guaranteed by, a sovereign entity or a multilateral development bank that are liquid and readily marketable and subject to certain conditions),and Level 2B (include certain publicly traded corporate debt securities and publicly traded shares of common stock that are liquid and readily marketable).

The proposed LCR's definition of HQLA incentivizes covered companies to require derivatives collateral in the form of U.S. Treasuries and Ginnie Maes which are considered "Level 1" HQLA which have a 100% HQLA value -- and excludes from the definition of HQLA: (i) Securities issued by insurers, banks, swap dealers (as defined in the Commodity Exchange Act or Securities Exchange Act), and any other company included within the proposed LCR's definition of "regulated financial company" (RFC); and (ii) All asset backed securities and non-Agency residential mortgage backed securities ("RMBS") and commercial mortgage backed securities ("CMBS"). Based on the foregoing, a key example of an HQLA Level 1 asset is a security interest by, or guaranteed by the full faith and credit of the U.S. government, such as a Treasury bill and a GNMA security. GNMA securities are the only mortgage-backed securities that are backed by the "full faith and credit" guaranty of the United States government. These securities, or "pools" of mortgage loans, are used as collateral for the issuance of securities on Wall Street. Mortgage backed securities ("MBS") are commonly referred to as "pass-through" certificates because the principal and interest of the underlying loans is "passed through" to investors. Because of Ginnie Mae's financial backing, these MBS are particularly attractive to various investors and, like other Agency MBS, are eligible to be traded in the "to-be-announced," or "TBA" market.

Unfortunately, the proposed rule's stringent HQLA Level 1 requirement will have a negative effect on smaller banks such as IBC's subsidiary banks. More specifically, the increased demand for GNMAs by large banks subject to the proposed rule's liquidity requirements will increase their market pricing causing smaller banks to have to pay more to purchase GNMAs. This will negatively affect smaller banks by impairing their return on equity and perhaps driving some to higher risk-weighted investments.

The foregoing HQLA standard is narrower than the Basel's definition of HQLA in that the range of acceptable assets is more restrictive. For example, the proposed rule's HQLA definition does not permit covered bonds and securities issued by public sector entities, such as a state, local authority, or other government subdivision below the level of a sovereign (including U.S. states and municipalities), to qualify as HQLA.

More specifically, the proposed rule's HQLA definition expressly excludes securities issued by any financial institution, defined broadly to include regulated banking and securities companies, registered and private investment funds, pension funds, and consolidated subsidiaries of any of them. In addition, municipal (State and city) debt, and covered bonds. In addition, municipal (State and city) debt, and covered bonds are excluded from the proposed rule's HQLA definition.

We strongly urge the Agencies to adopt the Basel accord's broader HQLA definition in order to minimize the negative effect that the proposed rule's current HQLA definition will have on smaller banks' ability to purchase GNMAs. For example, the Agencies should make investment grade U.S. municipal securities eligible for HQLA designation. Despite being assigned a 20% risk weight under the Agencies' own regulatory capital rules, the Agencies, in direct contradiction to the Basel accord's LCR, have stated in the proposed rule that they do not expect municipal securities to qualify as HQLA because they "believe that, at this time, these assets are not liquid and readily-marketable in U.S. markets and thus do not exhibit the liquidity characteristics necessary to be included in HQLA under this proposed rule." We believe that the liquidity in the municipal market is, by each measure, at least comparable to, and in some regards greater than, the liquidity in the investment grade, nonfinancial corporate bond and GSE debt markets. As such, we believe that municipal securities, as an asset class, do satisfy the proposed definition of liquid and readily marketable, and so should be eligible for classification as High Quality Liquid Assets. Furthermore, similar to the repurchase agreement ("repo") markets for Treasuries, Agencies, GSE debt and corporate bonds, there are deep, diverse and well-developed secured funding markets for municipal securities. Given the size, depth and stability of these financing options, municipal securities clearly meet the Agencies' requirement of "a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions" and should, therefore, be eligible for classification as HQLA. Since the Agencies specifically require that HQLA be eligible to be pledged at a central bank, it is important to note that the U.S. Federal Reserve accepts all U.S. municipal bonds at a 2% to 5% haircut, depending on maturity. These are the same haircuts that the Fed applies to U.S. Agency and GSE securities. By comparison, however, the Fed accepts U.S. AAA corporate bonds at a 3% to 6% haircut and all other investment grade corporate bonds at 5% to 8% haircut. The U.S. Federal Reserve already acknowledges the high credit, diversification and liquidity value of municipal securities by accepting them at the same haircut as U.S. Agencies and GSE issues and at better haircuts than U.S. corporate bonds. We respectfully request, therefore, that the Agencies amend the proposed rule in order to be consistent with the U.S. Federal Reserve's own liquidity criteria by permitting municipal securities to be eligible for qualification as HQLA.

Finally, the municipal market has a deep and diverse composition of buyers, sellers and dealers. The financial sector owns a small portion of the market, and municipal securities constitute a small portion of financial sector assets. In consideration of the foregoing, we request that the Agencies acknowledge the beneficial correlation and diversification qualities of municipal securities by making them expressly eligible for inclusion as HQLA.

Failure to expand permissible HQLA investments in accordance with the Basel accord will place *all* U.S. banks at a significantly competitive disadvantage, including the smaller banks that are not directly subject to the proposed rule's requirements as the market for and pricing of GNMAs will increase significantly.

B. FHLB Advances

Under the proposed rule, Level 2A HQLA would include certain claims on, or claims guaranteed by a U.S. government sponsored enterprise ("GSE"), such as Federal Home Loan Banks ("FHLB"). Level 2 HQLA may comprise no more than 40% of a covered company's HQLA, and the proposed LCR would apply a significant 15% haircut to Level 2A HQLA such as FHLB borrowings.

Limiting the use of FHLB lines of credit for liquidity purposes creates a further drag on financing as banks seek more regulatory-favored sources of liquidity (*i.e.*, Level 1 HQLA). FHLB borrowings have been an increasingly important source of funding for community banks particularly as core deposits as a percentage of community bank total assets has declined due to increased competition from mutual funds and the stock market. The funding sources of community banks are very limited compared to their large bank competitors. FHLB borrowings have been a primary source of liquidity for community banks, especially during times of stress like the most recent economic crisis. Based on the foregoing, we respectfully request the Agencies to permit depository institutions with less than $50 billion in total consolidated assets to continue to borrow from the FHLB as an important funding source and that these borrowings qualify for Level 1 HQLA for the community banks, but not for the banks with more than $50 billion in total assets.

III. Demand for Highly Liquid Assets Will Have Negative Impact on Community Banks

It is anticipated that the Liquidity Coverage Ratio will create a shortfall of highly liquid assets. One commentator recently reported that a Fed official has estimated that the large financial institutions' access to highly liquid assets will be collectively short by roughly $200 billion, if the new liquidity plan is finalized. The shortfall will have an extremely negative impact on all financial institutions because the demand will drive the price up of the highly liquid securities and make it difficult and expensive to purchase those securities.

Community financial institutions, like the IBC Banks, rely on the availability of highly liquid assets, especially Ginnie Mae securities, to meet collateral requirements related to their funding needs. The unavailability of affordable, highly liquid assets will impact the funding terms and margins of all banks. Also, the unavailability of highly liquid assets will result in higher risk weighting of community bank assets and, thereby, increase the capital requirements of community banks. This will prove to be a harsh impact for community banks because they do not have access to the capital markets like the large banks and it is becoming increasingly difficult for community banks to raise capital.

IV. Longer Transition Period

The proposed rule suggests that most covered banks are already in compliance with its requirements. However, in order to minimize the likelihood of an immediate, negative, and disruptive impact on the financial markets, including the GNMA market, we strongly encourage the Agencies to follow the Basel accord's compliance deadline of *January 1, 2019*.

Thank you for your consideration.

Respectfully,

Imelda Navarro
Treasurer