International Bancshares
Corporation

July 9, 2018

Via Federal eRulemaking Portal: www.regulations.gov
Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW., Suite 2E-218
Washington, DC 20219

Via Agency Website: www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm
Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Via Agency Website: https://www.fdic.gov/regulations/laws/federal/
Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW.
Washington, DC 20429

Re: *OCC* – Docket ID OCC-2018-0009; (12 CFR Parts 1, 3, 5, 23, 24, 32, 34, and 46);
FRS – Docket No. R-1605 and RIN 7100-AF04; (12 CFR Parts 208, 211, 215, 217, 223, 225, and 252 (Regulation Q));
FDIC – RIN 3064-AE74; (12 CFR Parts 324, 325, 327, 347, and 390);
Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Conforming Amendments to Other Regulations.

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 over $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 agencies' proposed capital rule amendments are very important to IBC's subsidiary banks and we appreciate the opportunity to comment.

On April 13 and 17, 2018, the federal banking agencies (Federal Reserve Board, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation) jointly published proposed rules that would amend their regulatory capital rules to respond to banking organizations' implementation of the new Current Expected Credit Losses (CECL) methodology

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under U.S. Generally Accepted Accounting Principles (GAAP).[1] Adoption of the CECL accounting standard necessitates one-time adjustments to retained earnings, temporary difference DTAs (deferred tax assets), and credit loss allowances eligible for inclusion in regulatory capital, which will impact a banking organization's regulatory capital ratios.

Under the proposed rules, all banking organizations would have the option to elect a three-year phase-in of the "day 1" regulatory capital effects from adopting CECL (referred to as the CECL Transition Provision) if they experience a reduction in retained earnings as a result of adopting the new accounting standard. Further, the CECL Transition Provision would be comprised of the separate impacts to retained earnings and temporary difference DTAs, and the difference between the pre-CECL allowance for loan and lease losses (ALLL) and the newly defined post-CECL allowance for credit losses (ACL). Phase-in of the CECL Transition Provision would be calculated on a straight-line basis over a three-year period. The election to use the phase-in approach would be required to be made by the end of the first regulatory reporting period in which the banking organization applies CECL, otherwise it is forfeited. A depository institution holding company and its subsidiary depository institutions would be eligible to make the phase-in election independent of one another.[2]

Under the proposed rules, banking organizations would be required to update certain regulatory disclosures to reflect the adoption of CECL.

All banking organizations that are subject to the agencies' regulatory capital rules and file regulatory reports that are required to conform to U.S. GAAP are covered by the proposed rule. The agencies intend to use regulatory capital ratios adjusted by the CECL Transition Provision when determining whether a banking organization that has elected the phase-in approach is in compliance with its regulatory capital requirements.

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[1] The CECL accounting guidance was issued in 2016 as part of Accounting Standards Update No. 2016-13. The effective date varies for different banking organizations based on certain characteristics; it becomes effective for the first group of banking organizations in their first fiscal year beginning after December 15, 2019, including interim periods within that fiscal year (e.g., quarterly reports). Early adoption is permitted for all banking organizations for fiscal years beginning after December 15, 2018.

[2] Under the proposed rules, a new defined term, "allowance for credit losses" or ACL, would take the place of ALLL for banking organizations that have adopted CECL. ACL would include credit loss allowances related to financial assets measured at amortized cost, except for allowances for PCD assets (purchased credit-deteriorated assets). It would also exclude allowances for AFS (available-for-sale) debt securities. ACL would be eligible for inclusion in Tier 2 capital subject to the current limit for ALLL. PCD assets and AFS debt securities would be treated separately. The agencies are also proposing to revise the regulatory definition of "carrying value" under the capital rules to provide that, for all assets other than PCD assets and AFS debt securities, the carrying value is not reduced by any associated credit loss allowance.

Comments

Undue Burden on Banks and Operational-System Challenges

CECL will impose considerable and burdensome operational-system challenges to banks that are already struggling to meet demanding regulatory requirements arising from the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). These include Basel III risk-based capital requirements, and onerous consumer protection regulations, including in mortgage lending.

Under CECL, banks will require significant time, manpower, and financial resources to change their accounting and reporting systems to collect the type of data that will be required to estimate prospective losses. From an operational standpoint, massive changes in bank core information operational systems will be required throughout the country. CECL's requirements will require a much greater degree of analysis and a much higher cost to administer with no significantly measureable benefit. The loan accounting systems currently available do not have all of the capabilities necessary to handle the nuances and variables that will be required in order for banks to comply with CECL, particularly on such large scale. The current methodology utilizes a historical loss model, and if applied correctly and supplemented by adequate disclosures, is more accurate in modeling loan loss reserves. However, under CECL, this practice will not be permissible. Major systems revisions and/or new financial and risk systems will be required to comply with CECL's requirements. The development of these new systems and models will require an enormous investment and significant amounts of time and resources to implement across the financial services industry without significant benefit for the users of financial statements.

The lack of systems capability will present significant operational challenges and risk for banks, particularly as it relates to complying with the Sarbanes-Oxley Act of 2002 and other regulatory requirements. These challenges range from the appropriate development of assumptions, availability of qualified staffing to handle the required intensive analysis, including reconciling models, to the lack of available systems for tracking and accounting for these loans. CECL presents many challenges that regional and community banks, unlike the mega-banks, are ill-equipped to handle.

We believe that the hundreds of millions of dollars that will be spent by banks to acquire systems, implement a multitude of new processes and systems to comply with CECL's requirements will far exceed any benefit that may be derived. The tremendous resources needed to accomplish this will dwarf the nominal, and arguable, value of the information derived, thereby failing the cost/benefit criteria of most sound rulemaking. The significance of the transformations of existing accounting and credit risk management systems that are required to implement CECL must not be underestimated.

Furthermore, attempting to predict credit loss for the life of a loan is subjective and an improper methodology for calculating loan loss reserves. To assume future loss that may or may not occur is a subjective prediction. CECL is inherently flawed as it requires banks to reach out into the entire life of the loan in order to predict credit loss. Unfortunately, the longer the loan

period to estimate or predict credit loss, the less accurate and reliable the data and stated credit losses will be. It is erroneous to think anyone can predict the losses on a loan years into the future. This is particularly true as banks and their accountants cannot predict economic events well into the future any more than analysts and economists can predict the stock market, interest rates or the economy with any degree of precision that would qualify as sufficiently reliable for use in financial statements. We note that the federal government did not foresee the occurrence of the mortgage meltdown and 2008 financial crisis. Recognizing credit losses which may or may not occur until well into the future is prognostication, not accounting. Furthermore, no bank makes a loan with the knowledge that a loss may occur. Ninety-nine percent of bank loans suffer no losses during their lives making estimates of future losses even more difficult based on historical experience.

No one can project potential loss uniformly across the banking system and clearly not at the community bank level where these banks by their very nature are not uniform in their approach to lending. The current system is more a reflection of this uniqueness. Basically, no two community banks are the same but these kinds of changes fail to account for this uniqueness. It should be abandoned especially for banks under $250 billion.

CECL's Negative Impact on Earnings, Capital, and Regulatory Capital Ratios

CECL is likely to have a negative impact on U.S. banks' reported earnings and capital and on regulatory capital ratios, as well as on regulatory limitations based on capital (*e.g.*, loans to affiliates, lending limits). This is a result of larger loan loss reserves being required at an earlier date. It could also have a negative impact on lending because higher reserves would seemingly be required at the inception of a loan if recent loan loss experience on a portfolio basis had increased and conversely, lower initial reserves if recent loan loss experience had declined. Because the bank regulators limit dividends and stock repurchases based on earnings, any reduced earnings resulting from CECL will constrain dividends.

Specific CECL Comments

IBC supports the proposed rules' provision providing all banking organizations the option to elect a three-year phase-in of the "day 1" regulatory capital effects from adopting CECL (referred to as the CECL Transition Provision) if they experience a reduction in retained earnings as a result of adopting the new accounting standard. However, based on the foregoing grave concerns with CECL, we believe the federal banking agencies should seriously considering adopting a longer phase-in period. A five-year phase-in period would be much more beneficial and realistic.

We believe most community and regional banks will experience a reduction in retained earnings as a result of adopting CECL and they need alternatives to suffering adverse impact to regulatory capital. The banking industry already has "life of loan" reserves in its financial statements in the form of capital. Capital and reserves are very similar. They are both available to absorb losses. Allocating more capital to "life of loan" reserves, as mandated by current rule, by employing highly subjective and inherently inaccurate "life of loan" estimates does not improve the quality of income statements or balance sheets. Regulators are already requiring significant

excess capital and changes to risk-based capital rules, to build significant cushions for future financial crises (e.g., Basel III). Regulators also constantly monitor for appropriateness depending on the bank's activities and economic environment, including unforeseen events and other risks. Under CECL's aggressive loss recognition model, the banking industry will effectively be paying several times over for the same losses, even though those losses may never be incurred. We also believe this will unnecessarily hurt the economy, banks' ability to lend, and bank stock valuations, without any improvement in the reliability and relevancy of financial statements.

Community banks are currently preparing to add a forward-looking component to their allowance-for-loss calculation, and discussing the new system with independent auditors to confirm agreement with the planned calculation. New information will be required for footnote disclosures in financial statements, so we need to extract it from our data-processing and core systems, and arrange it in the proper format. Furthermore, community banks need to ensure our employees are prepared to gather and retain the data we'll use to build and test models that work for us. Establishing and evaluating these processes will take time; thus, a three-year phase-in period is beneficial; however, a five-year phase-in period would be more appropriate in light of the rule's complexities.

The FASB CECL rules appear now more flexible and scalable than originally proposed in 2011, and hopefully, will allow community banks to continue using their personal understanding of their local markets—instead of complex modeling systems—to determine their loan-loss reserves. Allowing community banks to evaluate and adjust their loan-loss amounts using qualitative factors, historical losses and current systems has been essential to preserving the community banking model itself. As originally proposed in 2011, the CECL model would have superimposed a one-size-fits-all approach designed for homogeneous pools of commoditized loan products.

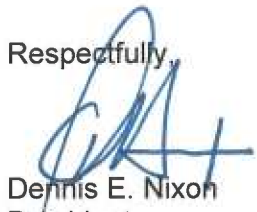
IBC opposes any impairment model for portfolio loans and investment securities that would increase costs and regulatory burdens for small and mid-size community banks. The initial version of FASB's CECL model would have required small community banks to use complex cash flow modeling to generate expected losses over the life of the loan or security. Such modeling would have required community banks to dedicate valuable resources to model selection, testing, production, and maintenance in addition to extensive data sourcing, warehousing, and administration. This expenditure of resources would have limited community banks' potential for loan growth and constricted economic expansion in local communities.

Fortunately, in its final version of the standard, FASB determined that smaller institutions should be allowed to utilize existing processes to project future credit losses. These include spreadsheets, narratives, and other noncomplex estimation efforts. Bank regulators have expressed a willingness to accept forward projections of future losses using these existing tools and processes as well. However, implementation of the final standard does not start until 2020 or later, and many details surrounding appropriate techniques for estimation of future losses have yet to be determined. It is imperative that community banks play an active role in the implementation of the final standard to ensure regulators honor FASB's view of it and do not require small community banks to implement complex modeling techniques.

For larger community banks and those that choose to adopt a cash flow modeling approach, modeling inputs should not be more difficult to source, maintain, and apply than is warranted by the underlying risks being identified and measured. "Best practices" with regard to model inputs that may be appropriate for larger institutions must not become de facto requirements for community banks. Finally, regulators must be transparent in their assessment of community bank credit risk management processes. We urge the federal banking agencies to publish formal proposed guidance for comment that allows community banks of all sizes to meet examiner expectations for sound risk management policy.

Thank you for your consideration.

Respectfully,



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