

May 13, 2013

Via E-MAIL (director@fasb.org)

Technical Director FASB 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re:

FASB File Reference No. 2012-260; Proposed Accounting Standards Update, Financial Instruments—Credit Losses (Subtopic 825-15)

Dear Board Members and FASB Staff:

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 \$11.5 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 matter.

On December 20, 2012, the Financial Accounting Standards board ("FASB") issued for public comment a new approach to accelerate the recognition of credit losses ("Proposed Rule"). In the Proposed Rule, FASB cited a perceived delayed recognition of credit losses as a weakness in current U.S. generally accepted accounting principles ("GAAP"). The Proposed Rule would change the way in which banks account for expected losses on loans and other debt securities and financial assets. The Proposed Rule removes the existing "probable" threshold in GAAP and replaces it with an allowance for expected credit losses. Current U.S. GAAP includes five different incurred loss credit impairment models that generally delay recognition of credit loss until the loss is considered probable or has been incurred. Under the Proposed Rule, an entity would be required to impair its existing financial assets based on an allowance for expected credit losses. Under the Proposed Rule, there would be a single measurement—a current estimate of expected credit losses on financial assets over the lifetime of each financial asset.

According to the Proposed Rule, bank management would be required to incorporate more forward-looking information in reporting on credit losses. As well as using available current and historical data, they would also need to consider forecasts of future losses.

¹ The financial assets covered by the Proposed Rule include most debt instruments (whether classified at amortized cost or at fair value with qualifying changes in fair value recognized in other comprehensive income), reinsurance receivables, lease receivables and loan commitments that are not unconditionally cancellable.

The allowance for expected credit loss would be based on a broad range of information. Relevant information includes past events, historical loss experience with similar assets, borrower specific creditworthiness, current economic conditions and reasonable forecasts about the expected collectability of the assets' remaining cash flows.

On the balance sheet, U.S. banks would be required to reflect current loss expectations in the "allowance for credit losses" account. The income statement would capture deterioration or improvement in credit loss expectations through changes in the provision for bad debt expense.

I. Comments

A. Undue Burden on Banks and Operational-System Challenges

The Proposed Rule will impose considerable and burdensome operational-system challenges to banks that are already struggling to meet new and demanding regulatory requirements arising from the Dodd-Frank Act. These new requirements include stress testing requirements, upcoming Basel III risk-based capital requirements, and new, onerous consumer protection regulations, including mortgage lending.

If the Proposed Rule is adopted, 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. The Proposed Rule's requirements will require a much greater degree of analysis and a much higher cost to administer. The loan accounting systems available currently 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 the Proposed Rule's requirements, particularly on such a large scale. The current methodology utilizes a historical loss model, if applied correctly and supplemented by adequate disclosures, is a more accurate model to determine loan loss reserves. However, if the Proposed Rule is adopted, this practice will not be permissible. Major systems revisions and/or new financial and risk systems would be required to comply with the Proposed Rule's requirements. The development of these new systems and models would 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 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. The Proposed Rule presents many challenges, particularly for regional and community banks that unlike the mega-banks, are not equipped to handle.

The development of all these new systems and valuation models would 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. I believe that the cost of implementing the necessary processes and systems will far exceed any benefit that may be provided by the Proposed Rule. The hundreds of millions of dollars that will be spent by banks to acquire systems, implement a multitude of new processes to comply with the Proposed Rule'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 would be required to implement the Proposed Rule should not be underestimated.

Furthermore, attempting to predict credit loss for the life of the 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. The Proposed Rule 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 period of time banks have to go out 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, itself, 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 prediction, 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.

B. Accounting's Matching Principle

The Matching Principle, one of the primary principles of accrual accounting, states that expenses should be recorded in the same period as the revenues that relate to those expenses. The Proposed Rule, by requiring expected future loan losses to be recorded immediately, violates this principle. This occurs because the interest income from the loan portfolio will be recognized over the life of the portfolio, while the credit losses will be recognized immediately. All loans have an interest rate that compensates the lender for credit risk and, generally, the higher the credit risk, the higher the interest rate. So, for those loans that are priced higher as it relates to the interest rate, the recognition of income (interest earnings) will take significantly longer than the recognition of the expense (credit losses). Additionally, the Proposed Rule also violates another basic principal of accrual accounting -- that expenses be recorded when incurred. Recording a provision for loan and lease losses today for losses that may or may not occur in the future, is recording an expense that has not been incurred, and is not proper. Since no bank knowingly makes a bad loan, loan losses as such are not predictable. Most losses that do occur are specific to a loan and its particular circumstances and those circumstances are usually event-driven. No one can accurately predict unknown events with any accuracy. Loan loss accounting should not become guess work.

C. Negative Impact on Bank Capital

1. Generally

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 the Proposed Rule, by employing highly subjective and inherently inaccurate "life of loan" estimates does not improve the quality of income statements or balance sheets. Capital, through earnings, should only be appropriated for loss reserves when a loss is probable and estimable or has already been incurred. Periodic income statements should reflect current events (including accruals for liabilities and costs which are probable and estimable or have been incurred), not inherently unreliable forecasts of cash flows years into the future.

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. If FASB adopts the Proposed Rule'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. FASB must recognize that regulators do not let banks ever use capital without replacing it, so booking loan losses upfront will require more raising of capital. This will hurt the economy and bank stock valuations, without any improvement in the reliability and relevancy of financial statements.

2. Reduction in Tier 1 Capital

Existing regulatory capital requirements permit banks to include in Tier 2 capital the general (as opposed to specific) allowance for loan and lease losses up to 1.25% of total risk-weighted assets. Basel III includes the same standard. There has been no specific suggestion by U.S. bank regulators that this standard will change in response to accounting changes in the treatment of credit losses, although both U.S. and international bank regulators have indicated that they will monitor the impact of accounting changes on regulatory capital standards. Absent any change, the transfer from capital to the allowance for expected credit losses effected by the Proposed Rule will reduce total capital as well as Tier 1 capital.

3. Stress Tests

The many banks that are required to conduct stress tests under the Federal Reserve's recently implemented stress test requirements pursuant to Section 165 of the Dodd-Frank Act, will need to carefully evaluate the interplay between the base, stressed and severely stressed scenarios used for purposes of those rules as compared to the scenarios used for purposes of calculating expected credit losses under the Proposed Rule, if implemented. The interplay between these scenarios are likely to negatively impact U.S. banks' capital requirements as regulators will seek more and more capital from banks.

D. Negative Impact on Loan Loss Reserves

In recent years, the bank regulators have become much more proactive in evaluating and criticizing both individual bank loan loss reserves and the methodology used in establishing those reserves. For example, all of the federal banking regulators issued an *Interagency Policy Statement on the Allowance for Loan and Lease Losses* in 2006. Existing requirements in FAS 5 and FAS 114 adequately address credit losses and provide appropriate information for regulators and shareholders. The complexity and uncertainty of the Proposed Rule's new standard could create further strain between banks and their regulators in this area.

E. Negative Impact on U.S. Bank's Earnings and Dividends

As noted above, the Proposed Rule 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 the Proposed Rule will constrain dividends.

F. Incomplete Scenarios for Expected Credit Loss Estimates

The Proposed Rule provides that the estimate of expected credit losses "shall neither be a worst-case scenario nor a best-case scenario," but rather shall reflect "both the possibility that a credit loss results and the possibility that no credit loss results." Although the Proposed Rule goes on to state that a probability-weighted calculation of multiple outcomes is not required, it does not address how the standard would be met without a probability-weighted calculation. If the Proposed Rule is adopted in final form, this issue must be clarified.

G. Retroactive, One-Time Cumulative-Effect Adjustment

The Proposed Rule does not specify an effective date. Instead, it provides that FASB will establish the effective date when it issues final amendments. It goes on to specify that a financial entity impacted by the proposed amendments would record a "cumulative-effect adjustment to the statement of financial position" as of the beginning of the first reporting period in which final amendments become effective."

Based on the foregoing, it appears that the Proposed Rule would be retroactive, with a one-time, cumulative effect adjustment to be made upon its effectiveness. This could significantly affect capital (but, presumably not income). Questions will arise as to whether banks must include the potential adjustment in their capital planning exercise and public disclosures.

II. Conclusion

Finally, existing accounting principles are already sufficient to produce reliable and credible financial statements. I strongly recommend that FASB withdraw, or substantially modify, the Proposed Rule that would require future loan losses to be recorded immediately because it is inconsistent with other accounting principles and would serve only to distort the capital ratios of the banks at a time when other regulatory requirements, e.g. Basel III and Dodd-Frank are requiring increased levels of bank capital.

Thank you for your consideration.

Respectfully

Dennis E. Nixon President