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September 19, 2014

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002
Basel, Switzerland

Re: Supervisory Guidelines for Identifying and Dealing with Weak Banks

Dear Ladies and Gentlemen:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the consultative document, *Supervisory Guidelines for Identifying and Dealing with Weak Banks* (the “Document”). ICBA recognizes that the Basel Committee on Banking Supervision (“BCBS”) has done an excellent job in both outlining an extensive framework for identifying a weak bank and describing the vital tools and approaches needed to thoroughly implement a risk-based supervisory review process in local jurisdictions around the globe.

However, ICBA would like to express its renewed concern about the BCBS flawed endorsement of using taxpayer funds to create “too big to fail” megabank bailouts that allow these institutions to take countless risks that they are unable to manage and that prudential bank regulators are ill equipped to understand and supervise to the degree necessary to ensure the safety and soundness of the global banking system. BCBS erroneously endorses an international consortium of the largest, interconnected, complex, and riskiest money center banking organizations that rely on taxpayers to backstop losses. When a banking organization cannot operate efficiently without a government backstop that institution has become too big to fail. BCBS should strongly discourage the use of taxpayer funds and instead focus its attention on its other resolution techniques. These alternative solutions, along with ensuring that the largest megabanks have sufficient levels of high-quality regulatory capital to survive periods of financial stress in the capital

¹ The Independent Community Bankers of America®, the nation’s voice for more than 6,500 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold \$1.3 trillion in assets, \$1 trillion in deposits, and \$800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA’s website at www.icba.org.

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markets, will help to ensure that the largest, internationally active and interconnected financial institutions are well-equipped to survive periods of weakness.

The Document

The document is timely in its publication as it recognizes the need to effectively address weak banks, most of which suffer from similar types of problems. Weak banks generally are the end result of poor management, inadequate capital, challenged business model, poor asset quality, and ineffective controls. When these problems exist in a bank, poor lending, excessive concentrations, inadequate liquidity, and uncontrolled balance sheet growth often occur culminating in the formation of a challenged financial institution that weakens the global banking system. A weak banking system, coupled with one or more global or regional economic factors, is a perfect recipe for a deep financial crisis.

The document states that regulators must be fully prepared to properly mitigate risks to the banking system by quickly identifying a weak bank. The obvious tools integral to effective supervision include onsite examinations, regulatory reports, advance warning mechanisms, business model integrity, and solid corporate governance. Less obvious but increasingly important assessment tools include bank data aggregation through information systems, stress testing at the institution and system level, detailed recovery plans, and effective internal controls.

The document provides detail on the bank supervisor's crucial job of providing systemic protection to the banking system through the formulation of a supervisory plan that identifies weak banks and systemic problems. The supervisory plan as stated in the document should include a plan of action based on whether the bank poses systemic risk. The supervisor must ensure that the bank has an adequate plan to deal with periods of unexpected stress with details on how to respond to capital and liquidity concerns. The document stresses that supervisors must be able to handle a range of problems depending on the type of weakness identified and in conjunction with other regulatory agencies if applicable. Forms of weakness include, but are not limited to concerns around business strategy, capital adequacy, asset quality, corporate governance, declining earnings, lack of liquidity, and management misidentification of risks.

The document stresses that in the event that a bank has no prospect of recovering from a period of traumatic stress, resolution paths should be in place to bring immediate resolution. Supervisors should not attempt to provide assurance that a bank will not fail. Further discussion is driven towards solutions that place private capital at risk and do not include taxpayers should be the first solution to minimize cost to taxpayers. BCBS states that resolution should be quick and transparent with a focus on minimizing market disruptions. Specific resolution solutions include restructuring plans, mergers, purchase or assumption, instituting a bridge bank, and direct capital injections using public funds. BCBS concludes that public funds should only be used once shareholders and debt holders have had their interests eliminated.

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ICBA's Comments

ICBA believes that BCBS has produced a very solid framework for identifying a weak bank when that financial institution is an internationally active, systemically important and interconnected bank. Isolating the symptoms and causes of bank weakness that contributes to failures and the need for corrective action and a path to resolution is an important step in minimizing the dangers that these institutions pose to the global financial system. The supervisory review process, with its emphasis on use of early warning indicators and tools, represents a very proactive approach to ensuring that a weakness is quickly identified and corrected. Equally positive is the need to implement an effective corrective action plan that requires one or more actions by the bank to ensure that levels of high-quality capital and sufficient liquidity are maintained or restored quickly in a transparent manner.

Where the document fails to adequately address the supervisory process for dealing with weak internationally active and systemically important banks is the endorsement of the option to use public funds in a bank bailout under any circumstance. Even though the document stresses the need to use public funds only in exceptional circumstances, BCBS is explicitly supporting the use of unlimited taxpayer funds to resolve a troubled institution, a position that endorses the promotion of large, too-big-to-fail megabanks that have outsized balance sheets and engage in the promotion of privatized profits and socialized losses. The need for public funds to be a part of any bank resolution plan is a self-admission that existing prudential bank regulation has failed in calling for sufficient capital to be present in the institution to protect against catastrophic loss and is therefore flawed regulation. As long as the bank's management is convinced that there is a public backstop that stands ready to provide unlimited bailout funds as needed, the bank will continue to use the most leverage possible to take excessive risks with depositor and shareholder funds in order to attain the highest economic returns possible.

Rather than rely on the disbursement of public funds to resolve troubled internationally active and systemically important banks, bank supervisors should set bank capital regulations that allow for sufficient levels of capital to be present to absorb any losses that could occur as a result of an unforeseen systemic crisis event. ICBA believes that strong capital requirements, in conjunction with other supervisory tools like stress testing and early warning indicators, can maintain stability within a country's internationally active and systemically important banks. A bank that possesses sufficient levels of high-quality capital and appropriate supervisory tools will always be able to weather an economic storm if a regulator's use of stress testing has properly identified the amount of capital needed. Stressing the importance of short-term liquidity, a vital component in the promotion of safety and soundness, is most useful when the largest global banks are sufficiently capitalized to make that liquidity available when needed.

ICBA would like to see BCBS focus more attention on setting sufficient regulatory capital levels for internationally active and systemically important banks. Additionally, limiting a bank's size relative to its peers and placing constraints on both the number and types of high risk investments that can be acquired to boost shareholder returns also

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deserves careful consideration. Resolution and exit strategies for these institutions will become less important if a strong capital framework is established and if size and core activities are restricted so that the failure of any one of these institutions would not have an overbearing impact on the sovereign financial system.

ICBA appreciates the opportunity to comment on this consultative document. If you have any questions or would like additional information, please do not hesitate to contact me at james.kendrick@icba.org or (202) 659-8111.

Sincerely,

/s/

James Kendrick
Vice President, Accounting & Capital Policy

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