IBC
International Bancshares
Corporation

September 11, 2015

Via email Rulemaking Portal: www.regulations.gov

Mr. Brent J. Fields
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-12-15, Comments to Proposed Listing Standards for Recovery of Erroneously Awarded Compensation (the "Proposal") by the Securities and Exchange Commission ("SEC")

Dear Mr. Fields:

The following comments are submitted on behalf of International Bancshares Corporation (NASDAQ: "IBOC"), a multi-bank financial holding company headquartered in Laredo, Texas. IBOC holds four state nonmember banks serving Texas and Oklahoma with each bank having less than a total of $10 billion in assets. With over $12 billion in total consolidated assets, IBOC is the largest Hispanic-owned financial holding company in the continental United States. IBOC is a publicly traded bank holding company that would be subject to the proposed new Rule 10D-1, and is required to file Form 10-K and annual proxy statements. We appreciate the opportunity to comment on the SEC's Proposal.

I. <u>Overview of the Proposal</u>

On July 1, 2015, the SEC proposed to add new rule 10D-1 under the Securities Exchange Act of 1934 and also proposed amendments to Items 402, 404, and 601 of Regulation S-K, Item 22 of Schedule 14A, Exchange Act Forms 20-F and 40-F, and Form N-CSR under the Exchange Act and the Investment Company Act of 1940. These new rules and amendments purport to implement the requirements of Section 954 of the Dodd-Frank Act ("Dodd-Frank"), although IBOC believes they go well beyond such requirements, and require national securities exchanges and associations to prohibit listing any security of an issuer that is not in compliance with Section 10D's requirements for disclosure of the issuer's policy on incentive-based compensation and the recovery of excess incentive-based compensation in the event of an accounting restatement to correct a material error.

By issuing the Proposal, the SEC aims to incentivize high-quality financial reporting by listed issuers through enhanced accountability, and to require companies to recover excess money paid to executives under incentive-based compensation policies in the event of a material error in financial reporting.

Under the Proposal, issuers listed on a national securities exchange or association would be subject to delisting if they (a) do not adopt a compensation recovery policy that complies with the applicable listing standard, (b) do not disclose the policy in accordance with the SEC rules, or (c) do not comply with the policy's recovery provisions.

6261396.6

To comply with the applicable listing standard in the Proposal, the compensation recovery policy must:

1. Require the company to recover from current and former executive officers based on the Section 16 definition of "officer;"

2. Be triggered upon the company's preparation of an accounting restatement to correct a material error, without regard to whether any misconduct occurred or the executive's responsibility for or control over the erroneous financial statements;

3. Apply to any cash or equity incentive-based compensation received on the basis, in whole or in part, of a "financial reporting measure;"

4. Require the recovery of excess compensation received during the three fiscal years preceding the date on which the financial restatement is required;

5. Require the recovery of the amount of incentive-based compensation received that exceeds the amount that would have been received based on the accounting restatement;

6. Provide that recovery is mandatory, with two narrow exceptions (applicable only if there has first been a reasonable attempt to recover the excess compensation):

    a. If the direct costs of seeking recovery would exceed the recoverable amount, or

    b. If recovery would violate the company's home country laws that are in place on or before the effective date of these rules.

The Proposal mandates that each listed company must file that policy as an exhibit to the company's annual report on Form 10-K. If a recovery is triggered, then the Proposal requires that issuers provide certain disclosures in those filings where executive compensation is required pursuant to Item 402, including annual reports on Form 10-K, the annual meeting proxy statement and any other proxy or consent solicitation materials requiring executive compensation information. The Proposal also requires that the disclosure required be provided in interactive data format using XBRL block-text tagging.

Section II of this letter includes our comments to the proposed rule and concludes that the SEC's Proposal, although well intentioned, will not accomplish the SEC's goal of encouraging better financial reporting and shareholder recovery of erroneously awarded compensation without embarking on costly legal expenses, and instead creates uncertainty and causes additional expense for registrants with minimal or no benefit to shareholders and potentially devastating effects on innocent individuals. Additionally, the Proposal will significantly negatively impact a public company's ability to recruit and retain talented officers.

II. Comments to the Proposal

A. Scope of Definition of "Current and Former Executive Officers"

The scope of those executive officers to whom the compensation recovery policy will apply under the Proposal includes the issuer's "president, principal financial officer, principal accounting officer, any vice-president of the issuer in charge of a principal business unit, division or function, any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer." This definition is too vague and too broad considering its strict-liability, no-fault nature, and could in some cases reach every officer (not just executive officers) of a company.

By including lower-level executives, such as vice-presidents in charge of principal business units, the Proposal subjects a large number of individuals to a harsh policy that is triggered as a result of an error over which many of them have absolutely no knowledge or control. For example, the primary industry in which IBOC participates, banking, traditionally has a corporate executive structure that includes many vice-president positions (e.g., vice-president of commercial lending, vice-president of corporate training, vice-president of marketing); having many employees with the title "Vice-President" is indicative of the banking industry. The overwhelming majority of these vice-presidents have no ability to control the accounting practices or financial reporting of IBOC. If one of the driving forces of the Proposal is to incentivize high-quality financial reporting, it is difficult to justify how a strict-liability policy attains that goal, particularly when it is not included in Dodd-Frank and is then made applicable to lower-level executives who have no control over financial reporting or who lack the ability to influence higher-ranking executives.

Additionally, the Proposal requires that the recovery apply to any incentive-based compensation awarded to a current executive officer before he or she became an executive officer, as long as he or she was an executive officer at some time during the three-year look-back period. Therefore, if an assistant vice-president of marketing, not in charge of a principal business unit, receives incentive-based compensation in 2015 and 2016, and is then promoted to the position of vice-president of marketing in 2017, this individual's incentive-based compensation will be subject to a required recovery for all three of those years, despite the fact that the financial reporting error potentially occurred at some point before he or she became an executive officer. To further highlight the injustice here, other assistant vice-presidents who have not been promoted during this time will be allowed to keep the incentive-based compensation they received during the same time period as the compensation now being recovered from the newly promoted vice-president.

A more equitable and effective recovery policy would target those individuals who have control over and responsibility for financial reporting of a listed issuer, and should take into account misconduct on the part of these individuals in triggering recovery. The policy could only require recovery from the top five executives for SEC disclosure purposes or the top five highest paid executives in the company, not including any subsidiaries, which should be considered separately. Additionally, a recovery policy should incorporate a grace period and target only the time period of the three-year look-back during which an individual was an executive officer as defined in the Proposal.

Absent the SEC making changes to these provisions, the application of this strict-liability policy is harsh and unfair, and is intensified by the fact that the calculation of recovery owed by the executive officer is done on a pre-tax basis, thus effectively reducing that individual's compensation to below what it would have been if the financial reporting had been accurate. In other words, the promotion in this case actually cost this vice-president money—a punishment rather than a reward, through no fault or responsibility of his or her own.

The tax treatment of returned compensation also presents technical issues with respect to the Proposal. Under general tax principles, the employee will be required to report the income in year the compensation is received, even though it is subject to a potential recovery, with the employer taking a corresponding tax deduction. Then after a financial restatement, the employee would not be able to necessarily amend his or her prior return as there is not a required mistake, and that individual instead would claim a deduction for the amount recovered in the tax year of the repayment. This is disadvantageous because an itemized deduction can leave the executive less than whole, as the deduction will most likely be limited due to phaseouts, tax rate differentials, deductibility floors, as well as the potential impact of the alternative minimum tax. Section 1341 of the Internal Revenue Code ("Code") could provide potential relief from this disparate tax treatment, but it would be preferable if the SEC would coordinate with the Internal Revenue Service ("IRS") to confirm that the amount subject to the recovery is excluded from income in the year repaid, particularly if other forms of compensation otherwise payable to the executive are used to offset the amount of the recovery.

Also complicating the issue is the effect on employment taxes that were withheld on the amount of compensation subject to the recovery or other payroll deductions. IRS guidance indicates the employment taxes could be credited against future compensation of a current employee, but what if the executive is now a former employee? Is a refund available? Furthermore, what is the tax effect to the employer recovering the erroneously paid compensation? If the employer previously took a tax deduction on the original payment it would be taxable income, not a recovery. The Proposal seems to completely ignore the catastrophic consequences that could occur to innocent officers who are typically in lower tax brackets and serving in "main street" public companies. These employees do not receive massive compensation packages and who would have no way to return the incentive-based compensation because it was spent meeting even modest lifestyle needs. If the definition will not be narrowed, the Proposal should consider a threshold limitation amount to protect the lower level officers who are not in a position to deal with the potential consequences of a recovery. Additional guidance should be coordinated with the IRS so that the negative tax implications are eliminated.

B. Accounting Restatement to Correct a "Material" Error

The Proposal requires recovery in the event that preparation of an accounting restatement is necessary due to the issuer's "material noncompliance" with any financial reporting requirement under the securities laws. While IBOC agrees generally with the idea that errors should be corrected and that a compensation recovery policy may be justified when there is a significant error, some additional guidance with respect to the point at which an error becomes "material" is needed.

The Proposal does not provide a meaningful definition or guideposts for listed issuers to follow when determining whether or not an accounting restatement might require the trigger of a compensation recovery policy. The SEC has only commented that an error "that is material to previously issued financial statement constitutes 'material noncompliance,'" without providing a more comprehensive definition of what the term "material" means in this context or offering examples of what material and nonmaterial accounting restatements look like. The Proposal also suggested that a series of small, nonmaterial corrections could constitute a material error if considered in the aggregate.

The SEC did not attempt to address the definition of materiality in the Proposal, citing two reasons: (1) "materiality is a determination that must be analyzed in the context of particular facts and circumstances" and (2) "materiality has received extensive and comprehensive judicial and regulatory attention." However, the fact that materiality must be judged on a case-by-case basis only complicates matters for an issuer's board of directors trying to determine whether the accounting restatement is to correct a material error for which it is required to embark on the potentially costly procedure necessary to recover the excess compensation in a strict liability context. Flexibility in the determination of materiality necessitates discretion of the board in determining if and to whom a recovery should be applied. Furthermore, if materiality has been addressed sufficiently by other agencies or branches of government, then it should be possible to provide some basic guidance to listed issuers to avoid uncertainty. The two court cases cited by the SEC in the Proposal do not address materiality in the context of an accounting restatement determination by a board of directors; instead they stand for the proposition that "an omitted fact is material if there is substantial likelihood that a reasonable shareholder could consider it important in deciding how to vote." If this is the standard by which the SEC intends listed issuers to abide, then it should be well articulated in the rules and tailored to compensation recovery under the proposed rules.

To further complicate the issue of "materiality," the Proposal indicates that a series of immaterial corrections might be considered material when viewed in the aggregate. The SEC provides no guidance as to the determination of when exactly these immaterial corrections cross the line and become "material" under these proposed rules.

If the SEC is not going to give boards of directors discretion to determine if and to whom a recovery should apply, then the SEC should provide more guidance with respect to the types and characteristics of errors it would consider to be "material." By failing to furnish further guidance on the required trigger for compensation recovery, the SEC has introduced an element of uncertainty as to exactly when recovery of compensation is required by the rules, allowing for second-guessing of the determinations made by a company's board of directors. Many accounting decisions are based on subjective judgments and not formulaic calculations. One accountant's view of an accounting estimate may be materially different than another accountant's view. In some cases, hindsight may be used to second-guess proper decisions. Accordingly, the Proposal potentially introduces an opportunity ripe for shareholder derivative litigation based upon a claim that the company should have reasonably determined that a restatement was necessary at an earlier date, especially when the recovery is based on a series of non-material corrections that constitute a material error when considered in the aggregate.

Furthermore, the ambiguity of what exactly constitutes a material error in the Proposal introduces the opportunity for gamesmanship following a change in leadership, with no defense to the strict-liability policy available to the executive officer no longer with the company.

C. Determination of Amount of "Excess" Incentive-Based Compensation

IBOC agrees with the SEC's general proposition that in the event of a significant restatement, recovery of excess incentive-based compensation might be necessary and in the best interest of a company and its shareholders. However, the Proposal requires that the compensation recovery policy cover "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure." The financial reporting measures include financial information, stock price and total shareholder return ("TSR").

First, of principal issue is the Proposal's use of the term "any compensation" to describe the compensation subject to potential recovery, with any related distribution from a retirement benefit payable under a pension plan included as recoverable compensation. If a company were to recover a retirement benefit in a qualified retirement plan, it would violate the anti-alienation provisions in Code Section 401(a), as well as create potential violations under the Employees Retirement Income Security Act ("ERISA"), subjecting the retirement plan to potential disqualification. Thus, the SEC should make clear that the recovery does not apply to a qualified retirement plan benefit, even if the amount credited to the retirement account was based on compensation subject to recovery.

Second, in order to pursue compensation recovery under the Proposal, a company that has offered incentive-based compensation based on stock price or TSR must perform potentially detailed and costly analyses in order to determine the amount of "excess" compensation because this information is not readily ascertainable from financial reporting measures. These analyses are expensive and require the company to procure services from third-party advisors, and yet the analyses are highly speculative and imprecise. Often they produce ranges of numbers, rather than a definite amount, introducing more uncertainty and opportunity to second-guess the company's decision on how much to recover, therefore opening the door for potential additional shareholder derivative litigation. If maximizing shareholder value is a motivator for the Proposal, it hardly seems prudent to require or expect a board of directors to recover when the restatement is insignificant or results in very little excess compensation, considering the expense necessary to comply with the new requirements for the compensation recovery policies.

The Proposal allows companies to use "reasonable estimates" in determining the impact of a material restatement on stock price and TSR, provided that the estimates are disclosed in its proxy statement, documentation of the determination is maintained and the applicable stock exchange is provided such documentation. While this makes the determination of an approximate amount possible, it does nothing to guide a company as to what a "reasonable" estimate might be and leaves the company open to second-guessing and even potential litigation from executives who dispute the amount of money they are required to return.

IBOC recommends that the Proposal be revised to allow the Board discretion on whether to pursue recovery of compensation, at a minimum, based on metrics such as stock price and TSR given that the cost of determining the excess could very easily outweigh the potential compensation to be recovered. Additionally, the SEC should address the use of "reasonable" estimates to eliminate the term's ambiguity and to provide clear guidance on estimates that will be considered reasonable under the Proposal.

D. Means of Recovery of Excess Compensation and Exceptions to Recovery

Under the Proposal, recovery of excess compensation includes cancellation of unvested equity and non-equity awards by offsetting against amounts otherwise payable by the issuer to the executive officer, such as deferred compensation. Instead of actual discretion, the Proposal provides the company must recover certain amounts if there is a material restatement, and provides what can only be called "mandatory discretion" as to the means of recovering the erroneously awarded compensation. The Proposal contemplates almost any form of compensation as a potential means of recovery, including deferred compensation. Absent amendment to the Treasury Regulations promulgated under Code Section 409A, use of deferred compensation as a means to repay an amount of erroneously awarded compensation totaling $5,000 or more could be considered an impermissible acceleration under Section 409A as a payment of a debt to the company. This potential violation of Section 409A could result in the imposition of a 20% excise tax on the covered executive. The Proposal should not require or allow a company to satisfy an obligation to recover the amount erroneously awarded if it would result in a tax penalty on the executive. Thus, company recovery policies should require compliance with Section 409A; absent such a requirement otherwise, the no-fault nature of the Proposal could result in a significant penalty to an innocent executive. Absent this exception being incorporated into the Proposal, an amendment would need to be implemented to Section 409A or the Treasury Regulations exempting the recovery from being considered a repayment of a debt to the company or another policy based permissible acceleration would need to be incorporated.

The recovery of excess incentive-based compensation is mandatory except under two circumstances, where (1) the direct costs of enforcing recovery would exceed the recoverable amount, or (2) the recovery would violate the company's home country law, so long as that law was adopted prior to the date of publication of these rules in the Federal Register. In order for a company to not recover under either of these exceptions, the company must have first made a "reasonable attempt" to pursue the recovery of that compensation. IBOC generally agrees that where it is in the best interest of the company and its shareholders, a company should attempt recovery of excess compensation that was not truly "earned" by the executive. However, the Proposal denies a company's board of directors the discretion to not pursue recovery of excess compensation in other situations where the pursuit of recovery might actually put the shareholders in a worse economic position than if recovery had never been initiated, and further creates unintended consequences when the board is required to seek alternative means of recovery. For example, in the case of excess compensation based on stock price or TSR, as discussed in Section C above, the mere process of calculating the excess recovery might well exceed the amount recoverable. This money would be spent before the company even arrives at the step of "attempting" to recover the amount from the executive. This is counter-productive to the goal of returning value to the shareholders.

A more practical option would be to allow a company's board of directors the discretion to make decisions about when recovery is in the best interests of the company and shareholders. This would also comport with the compensation recovery plans already in place for many companies, the majority of which allow their boards of directors discretion in making decisions about how to properly pursue recovery. Allowing a board to determine that the accounting restatement will likely result in recovery of a very small amount of money will prevent wealth from being transferred from shareholders to third parties such as analysts, accountants and lawyers in the process of attempting recovery of an unsubstantial amount.

Additionally, the SEC has allowed a foreign company the protection of its home country laws in the case where recovery would be in contravention of those laws. The treatment of foreign and domestic companies in this context does not accomplish the ultimate goal of recovering money that certain executives should never have received and returning that money to the company and ultimately, the shareholders. Providing an exception for certain companies from this rule produces an inequitable result by ultimately treating shareholders of some listed issuers differently than shareholders of other listed issuers, solely based on the laws of the country where the issuer is organized.

E. Potential Consequences: Higher Pay for Executives of Listed Companies to Cover Uncertainty and Loss of Alignment of Shareholders' and Executives' Interests

The Proposal introduces a significant level of uncertainty into the expectation an executive might have regarding his or her compensation, with that individual even potentially facing a penalty by repaying an amount calculated on a pre-tax basis with post-tax tax dollars, as explained in the example in Section A above. Likely consequences of this uncertainty, as explored by the SEC in the Proposal, include (1) an increase in base salaries and other non-incentive-based compensation of executives and corresponding decrease in incentive-based compensation, (2) the loss of alignment between the shareholders' and executives' interests, (3) the development of an insurance market to cover this risk and (4) inability to recruit and retain talented management due to the risk associated with employment and compensation.

First, as the SEC acknowledged, and as discussed in Section A above with respect to tax implications, a likely outcome of the Proposal will be that a smaller and more insignificant portion of executives' compensation plans will be comprised of incentive-based compensation, thus increasing the base salary of these individuals, and likely reducing the compensation tied to long-term performance periods and company stock. Another possible result is that executives might be paid more to account for the inherent risk due to the potential reduction in compensation in the event of a future restatement. In either event, the end consequence is that more money will be transferred out of the hands of shareholders and into the hands of executives that is not based on a performance matrix, thus the company will not receive a tax deduction under Code Section 162(m). In other words, executives who receive a larger base salary will be compensated regardless of the benefit to shareholders of better financial statements, after tax profit, stock prices or TSR. This must be considered keeping in mind that the definition of executive is very broad and is likely to encompass many individuals within larger companies, especially banks, as discussed in Section A, and, therefore, may represent in the aggregate a large sum of extra money to be paid every year to these executives.

Another potential outcome of the Proposal is that in an effort to keep executives' pay compensation plans deductible under Code Section 162(m)'s definition of performance-based compensation, but not subject to recovery, compensation arrangements will be based on objective performance goals (such as opening a target number of stores, for example) that may not be aligned with shareholder return. A move toward performance-based metrics in executive compensation plans will move shareholders' and executive interests further away from one another and is most likely not in the best interest of the company and its shareholders.

Also impacting the design of executive compensation plans, and not addressed by the Proposal, is the frequent negative discretion that is utilized in plans designed to benefit from Section 162(m) or awards based on stock price. Often an award will provide for a maximum bonus if certain financial targets are met by the company, but the compensation committee is granted negative discretion to pay less than the maximum bonus, which is based on another financial measure. The Proposal does not address if a recovery would be required when there is a financial restatement, and only one of the two financial targets are met. Nor does the Proposal adequately address how to determine the amount of recovery when the performance-based compensation was awarded based on stock price.

Secondly, the emergence of incentive-based compensation packages grew out of the idea that an executive who knows that he or she will be compensated for the company performing well will tend to perform at a higher level because that individual has a tangible incentive to work hard. This desire to drive the company to do well usually benefits shareholders as well as the executive; in other words, the interests of the shareholders and the executive are aligned. While IBOC agrees with the SEC that this system may create certain incentives for some executives to inflate or otherwise manipulate numbers contained in financial reporting in order to receive compensation to which they are not actually entitled, IBOC does not agree that the Proposal adequately addresses this issue. In fact, by offering more compensation independent of the company's performance, a company will be paying its executives as bureaucrats instead of as value-maximizing, performance-driven leaders who foster a culture of hard-working and driven employees. In the end, the shareholders are the ones who will lose out in this game, not the executives, especially considering the tax implications under Code Section 162(m) for the company if it pays a higher base salary. Furthermore, there are already many incentives in place to deter executives from inflating or manipulating numbers: criminal sanctions, civil actions and injunctions, penalties, and disgorgement, to name a few. Ultimately, each shareholder has the right to dispose of stock where that shareholder believes the leadership is defective. It is difficult to see how the Proposal will add a significant deterrent from misconduct such that it justifies the potential negative consequences to the shareholders that are likely to occur.

Third, as addressed by the SEC in the Proposal's Economic Analysis, another factor that could contribute to overall increase in executive compensation is the development of a market for insurance to protect compensation recovery. While the Proposal carefully denies companies the ability to directly indemnify executives or pay for the insurance premiums should an executive choose to purchase such insurance, it also acknowledges that an executive's compensation package would likely incorporate the cost of the insurance premium for the recovery insurance. Again, the outcome of this development appears to be a reduction in the wealth of shareholders and an enrichment of third parties, in this case the insurance companies and to some extent, the executives.

Finally, the Proposal disfavors listed issuers against unlisted issuers in the overlapping labor market for executives. In the Proposal's Economic Analysis, the SEC stated that the effects the Proposal will have on a listed issuer's ability to effectively compete for the best executive officers are mitigated to the extent these markets do not overlap. However, no documentation or research has been provided to support the contention that the markets do not overlap in any significant manner that is likely to affect a listed issuer's ability to attract executives to lead the company in the direction that is in the shareholders' best interest. In fact, narrowing the market of available and interested executives in any increment is not in the shareholders' best interest, because it means a smaller pool of talented individuals from whom to choose when recruiting management team members. Executive officer candidates, when faced with two similar companies, one listed and one unlisted, offering similar compensation packages and employment, will likely avoid the company offering compensation subject to a mandatory strict-liability recovery policy.

F. Disclosures – XBRL format

The Proposal indicates that if the company makes an accounting restatement to correct a material error, it will be required to make certain disclosures including annual reports on Form 10-K, annual meeting proxy statement, any other proxy or consent solicitation materials requiring executive compensation information. Additionally, the Proposal requires that the disclosures must be in XBRL format. The necessity for additional disclosures as well as the XBRL requirement increase the administrative cost to the registrant due to the substantial increase in the amount of information required for disclosure and the complexity of formatting data in XBRL.

Thank you for your consideration.

Respectfully,

Dennis E. Nixon
President and Chief Executive Officer