Bond Case Briefs

Municipal Finance Law Since 1971

ICBA Requests Change to Capital Conservation Buffer Rules for Subchapter S Banks.

The capital conservation buffer rules disadvantage community banks against larger financial institutions and tax-exempt credit unions and should be modified to allow subchapter S corporation banks to cover their income tax liabilities out of their profits, the Independent Community Bankers of America said in a February 19 letter.

February 19, 2014

The Honorable Thomas J. Curry

Comptroller of the Currency

Office of the Comptroller of the Currency

400 7th Street, SW

Washington, DC 20219

The Honorable Janet L. Yellen

Chair

Board of Governors of the Federal Reserve System

20th Street and Constitution Avenue, NW

Washington, DC 20551

The Honorable Martin J. Gruenberg

Chairman

Federal Deposit Insurance Corporation

550 17th Street, NW

Washington, DC 20429

Re: Implementation of the Capital Conservation Buffer

Dear Ladies and Gentlemen:

The Independent Community Bankers of America (ICBA)1 would like to express its continued concern about the implementation of the new Basel III capital conservation buffer rules for community banks in the United States. Specifically, the unique detrimental impact the buffer will have on the nation’s 2,000 banks structured as Subchapter S corporations is an immediate concern that needs to be remedied.

The community bank model is unique and represents a critical provider of banking services to many rural and underserved communities across the country. The continued progression of harmful bank regulation like the buffer is an immediate threat to the ability of many community banks to operate without undergoing a change in corporate structure, capital adequacy level, or business model. I urge you to revisit the recent decision by your agency to subject community banks to the buffer and work with the other regulatory agencies to develop a common sense solution that does not bring disproportionate harm to the nation’s community banks.

The buffer forces community banks to compete at a great disadvantage against the largest too-bi--to-fail financial institutions and tax-exempt credit unions. These subsidized financial institutions operate at reduced funding costs when compared to community banks either because they are flagged as critical to the stability of the global financial system and therefore too big to fail or they are not subject to taxation on income. Community banks operate with the understanding that losses are privatized, income taxes must be paid, and regulatory capital levels must be maintained at healthy levels all while providing critical access to financial services in local communities.

Notably, the buffer brings considerable harm to community banks organized as Subchapter S corporations under the Internal Revenue Code. These institutions are legally structured as corporations but are pass-through entities for income taxation. Bank profits are automatically taxed at the individual shareholder level. The buffer’s prohibition or limitations on the payment of dividends to shareholders in certain situations presents the real fear that a shareholder may be subject to income tax on community bank taxable earnings that cannot be distributed to cover the associated tax obligation due. The potential for this scenario will severely hamper future capital formation at Subchapter S community banks as shareholders will contemplate the risk of not being able to cover their income tax liabilities. Additionally, differences in regulatory, accounting, and taxable income amplify the negative impact of the buffer by penalizing certain high-quality assets like mortgage servicing rights. The tax reporting requirements for these assets when coupled with the buffer serve to decrease the marketability and succession planning of a Subchapter S community bank when trying to raise capital.

Ironically, the capital conservation buffer punishes the banks that are the most efficient users of regulatory capital and are most appropriately designed to maintain and rebuild common equity tier 1 retained earnings in times of severe economic stress. Subchapter S banks already face extreme capital raising restrictions in the number and type of shareholders they can have under the Internal Revenue Code. The buffer further jeopardizes capital raising options, is counterproductive, and undermines the goal of safety and soundness of the bank. The capital conservation buffer unfairly devalues many community bank franchises at a key point in the nation’s financial and economic recovery. Rapid consolidation of the banking sector will harm both consumer and business borrowers, especially in small, rural, and underserved communities.

Basel III was never intended to trip up small community banks and was created to apply to the largest, most complex, internationally active banks. ICBA requests that the capital conservation buffer be remedied to at least allow the income tax liability of Subchapter S corporation banks to be met on its profits just as C corporation banks are able to cover their tax liabilities directly out of income. ICBA requests that the capital conservation buffer be modified for community banks to allow them to distribute at least 35% of their reported net income for a reporting period. While not a perfect alternative, this solution allows community banks including Subchapter S community banks to be able to provide some level of relief to their shareholders when taxes are due.

ICBA appreciates your attention to this immediate concern and the harm that will be experienced without your further action. If you have any questions or would like additional information, please do not hesitate to contact me at (202) 659-8111.

Sincerely,

Camden R. Fine

President and CEO

Independent Community Bankers of

America

Washington, DC

FOOTNOTE

1 The Independent Community Bankers of America®, the nation's voice for nearly 7,000 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.

With nearly 5,000 members, representing more than 24,000 locations nationwide and employing more than 300,000 Americans, ICBA members hold more than $1.2 trillion in assets, $1 trillion in deposits, and $750 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com