American Bankers Association
Building Success. Together.

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The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Thomas Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Gentlemen:

The banking industry has followed with appreciation your valuable statements and congressional testimony about the importance of community banks to our nation. Your agencies, in addition, have conducted research and published important studies on community banks and the mounting challenges that they face. We believe that all of this work has created a strong basis for taking specific actions not only to preserve community banking in the nation but to create conditions for its vitality and growth for the benefit of the customers and communities that rely upon them.

Such steps would come none too soon. The FDIC's latest Quarterly Banking Profile, for the second quarter of 2013, reported a sad milestone. The number of banks in the United States declined to fewer than 7,000, a number last seen in 1891. I cannot tell you the exact optimal number of banks we should have in the United States, but I am confident that for the largest and most diverse economy in the world the trend is in the wrong direction, as the needs for financial services continue to grow rather than diminish. The Quarterly Banking Profile also reported that, "The last de novo charter occurred in fourth quarter 2010." The years 2011, 2012, and perhaps 2013, are the only years since the Civil War that have not witnessed any new banks chartered in the nation. That is to say, that even while we diagnose and document the problem the situation is not getting better. Bank employment was also reported as declining by 10,900 jobs over the previous 12 months. In your public statements you have pointed to similar disturbing trends.

Every day that these disturbing trends are not addressed sees further erosion of community banking. It's time to initiate a specific collective effort to identify changes that will make a difference and promote the strength and resurgence of community banking. To begin the discussion, we would propose to you several specific, concrete regulatory measures that you can take now. Undoubtedly, you know of additional steps to take, as do we. None of these require any additional legislation. We offer the following recommendations as a beginning:

Remove Punitive Regulation of Mortgage Servicing Assets. With many banks, mortgage servicing assets have been a safe source of income. For even more banks, mortgage servicing has been an important way to maintain valuable long-term customer relationships, important to customer and

bank alike. By removing the punitive regulation of mortgage servicing assets, community banks will be able to maintain their customer relationships that come from mortgage servicing.

Implement the Volcker Rule in a Way That Does Not Impose Compliance Obligations that are Inapplicable to the Business Model of Community Banks. In implementing the Volcker Rule, adopt an approach that places the burden on regulators to identify violations rather than on banks to prove their innocence. Few if any community banks engage in activities that the proponents of the Volcker Rule have described as needing corrective action. Nevertheless, the proposed implementing regulations would require virtually every community bank to establish a Volcker Rule compliance program to demonstrate to regulators that it is not violating the rule. Such a compliance program will provide no product or service to local communities, and yet the community bank would have to bear those compliance costs, for nothing. The Volcker Rule was announced as a tool to address systemic risk. No community bank poses any such systemic risk. If through normal bank examination inappropriate activities were identified, they could then be addressed through supervisory techniques without presenting any danger to the national financial system.

Implement a More Robust Ombudsman Program in Each Agency. Agency Ombudsman programs have the ability to play two roles of particular relevance to community banks: First, they offer an avenue of accountability to assure that the examination process is applied in a manner appropriate to the charter, business model, and size and scale of each bank's operations, rather than in a one-size-fits-all way. An examination needs an effective avenue for accountability because uncorrected examination errors can interfere with the ability of banks to provide services, cutting off customer access to credit, raising costs, and reducing product availability. The Ombudsman should have clear authority to take corrective action to remedy examination errors. Second, the Ombudsman can conduct confidential outreach to gauge community bank views of agency performance. This protected communication can encourage candid reviews against which an agency can measure whether actions to address community bank concerns are actually achieving their intent.

Simplify and Focus Reports of Condition. Reports of Condition (call reports) are important instruments of prudential supervision. The process of gathering and reporting relevant information can be important to banks, and collection and evaluation of the information reported is important for safety and soundness regulation. Over time, while new requirements have been added to Reports of Condition, few have been removed, even if their value has become small and outdated. In addition, proposals are currently pending to use Reports of Condition to gather market research data on deposit fee and remittance fee revenues, information loosely if at all related to safety and soundness supervision. The Reports of Condition should be culled of requirements that retain little or no safety and soundness value, and they should remain focused on their prudential supervisory purposes. Each additional data field on a Report of Condition can impose an outsized cost to community banks for gathering, certifying, and submitting the required information.

Allow Limited Distributions for Shareholders of S-Corp Banks to Pay Taxes on Earnings. Recent changes to capital standards, especially those implementing the international Basel III standards, seriously and inappropriately disadvantage Subchapter S corporation banks. There are some 2,000 banks so organized. Subchapter S rules require shareholders to pay federal income taxes on a firm's profits proportionate to the shareholders' ownership interest in the company—regardless of whether such profits are distributed to the shareholders. Normally, the shareholders are able to meet their tax

obligations from distributions they receive from the firm. Under the new bank capital rules, a bank is not allowed to pay dividends if its capital levels are not above the new required capital buffers. Yet, the tax obligation would remain, forcing bank shareholders to pay taxes on income that they have not received. This will create a powerful disincentive for investment in Subchapter S banks, critically harming the growth and perhaps even viability of Subchapter S banks, especially in times of economic stress. This problem can be easily resolved with a provision in the Capital Conservation Buffer section of the Basel III rules that would allow a Subchapter S bank to make limited distributions to shareholders for the sole purpose of paying taxes due on the bank's earnings. This would put the S corporation banks on the same footing as C corporation banks whose taxes are paid regardless of whether there is a restriction on dividend distribution.

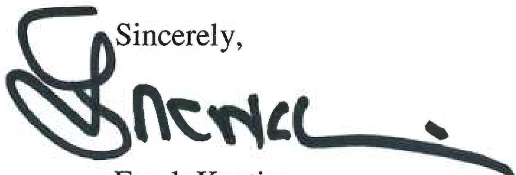
Acknowledge the Competitive Disadvantage Community Banks Face Against Credit Unions and the Farm Credit System. Every day, community banks compete head-to-head with tax-exempt credit unions that are the same size as they are (or often larger) and offer the same products and services. Banks also face aggressive direct lending from the tax-favored Farm Credit System. This unfair competition is increasingly becoming a safety and soundness issue as credit unions and farm credit institutions use their tax benefits to cherry-pick our bank customers while engaging in unsound underwriting and other risky business practices. As banking regulators, we request that you speak out about the competitive implications of the tax favored competition on community banks.

These are representative and achievable measures that would give life to our shared interest in supporting community banking. These suggestions are, of course, just the beginning as more certainly must be done to arrest the path of consolidation of our industry. Together, we should work to identify ways to:

- Conduct a calibrated approach to regulation that promotes and validates competitive diversity in the banking industry;
- Simplify regulatory and consumer protection compliance; and
- Apply supervisory oversight in a more constructive, value-added manner.[i]

We are prepared to meet with you—together with a group of blue-ribbon community bankers—to find actionable solutions in these and other key areas. Your help is essential to begin the resurgence in community banking that is important to so many communities around the country.

Sincerely,



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[i] Value-Added Bank Supervision: A Framework for Safely Fostering Economic Growth (copy enclosed)