American Bankers Association

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The Honorable Thomas J. Curry
Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Dear Comptroller Curry, Tom

I'm writing you once again to urge the OCC to permit any profitable bank organized under Subchapter S to provide a limited dividend equal to the tax liability it faces regardless of its capital levels within the capital conservation buffer. Doing so would make the tax treatment of similarly-sized Sub S and C-corp banks the same under the Basel III capital conservation buffer rules. It would eliminate the disincentives to building capital before times of stress ***and*** during times of stress—which is a primary objective of strong capital rules.

As you know, Sub S banks are typically small banks that have limited access to sources of capital. In fact, the OCC regulates 452 Sub S banks—equal to one of every five banks directly supervised by the OCC. The median asset size of these banks is $155 million—considerably smaller than the median-sized bank the OCC supervises which has assets of $200 million. Thus, this issue is very important for a large segment of the institutions your agency supervises, and smaller banks in particular.

We share the view that strong capital and positive incentives for holding sufficient capital are important. But this rule works counter to these goals. If Sub S shareholders know that they may be required to dig into their own pockets to pay taxes on earnings without having any distribution to cover that liability, they have incentives to invest less than they would otherwise in that bank in the first place—even in good times. More importantly, in times of stress, the Sub S shareholders would be very unlikely to inject new capital knowing they may not have dividends to pay taxes once the bank recovers and is profitable.

Thus, despite the obvious difference regarding how this rule would apply to Sub S banks, and despite the incentives that reduce rather than encourage capital formation, the OCC has chosen to apply the rule in exactly the same way regardless of Sub S or C-corp organizational structure. But the notion of applying the conservation buffers "identically" does ***not*** lead to identical results in practice. The OCC should develop and implement rules that have the ***same*** impact. Not doing so places Sub S banks at an economic disadvantage relative to non-Sub S banks.

The decision of the OCC ***not*** to address this clear disparity in impact (despite many letters by Sub S banks describing the perverse nature of the rule) struck me as completely at odds with the testimony recently given by Toney Bland, the Senior Deputy Comptroller for Midsize and Community Bank Supervision. In his testimony, he emphasized that "the OCC understands a one-size-fits-all-approach does not work, especially for community banks," and he stated that "community banks have different business models and more limited resources" and that the OCC "factor[s] these differences into the rules [OCC] writes and the guidance [OCC] issue[s]." He went on to say that the OCC seeks to minimize burden on community banks by "providing alternatives to satisfy prescriptive requirements, and using exemptions" as examples of ways the OCC tailors regulations to accommodate community banks.

If this is truly a statement of intent by the OCC to recognize the unique characteristics of community banks and to act accordingly, the one-size-fits-all treatment of Sub S and C-corp under this rule should be addressed and corrected.

Sincerely,

Frank Keating