Good$ense for Banks: Regulators Recognize Bank Dividend Needs in Light of COVID – 19

The Federal Banking Regulatory Agencies issued an Interim Final Rule with Requests for Comments on March 18, 2020 in response to the severe economic conditions caused by the COVID–19.

To better allow a banking organization to continue lending during times of stress, the agencies are issuing the interim final rule to revise the definition of eligible retained income to the greater of (1) a banking organization's net income for the four preceding calendar quarters, net of any distributions and associated tax effects not already reflected in net income and (2) the average of a banking organization's net income over the preceding four quarters.

Applicability: This definition will apply with respect to all of a banking organization's buffer requirements, including the fixed 2.5 percent capital conservation buffer, and, if applicable, the counter-cyclical capital buffer, the GSIB surcharge, and enhanced supplementary leverage ratio standards.

Once the SCB final rule is effective, this definition will also apply to all parts of a covered holding company's buffer requirements, including the stress loss portion of a covered holding company's capital conservation requirement. The agencies believe that having one definition for all banking organizations as part of this interim final rule simplifies the regulatory capital framework and ensures fairness across banking organizations of all sizes.

This interim final rule is intended to strengthen the incentives for banking organizations to use their capital buffers as intended in adverse conditions and serve as a financial intermediary and source of credit to the economy. This revision would reduce the likelihood that a banking organization is suddenly subject to abrupt and restrictive distribution limitations in a scenario of lower than expected capital levels.

The Effect on S-Corporation Banks and Shareholders

As you know, S-corporation banks do not pay federal income taxes, and instead the income and losses are passed through to their shareholders. In a situation where the S-corporation has income but does not pay dividends, its shareholders are responsible for meeting the increased tax liability from their own resources.

A situation in which S-corporation shareholders' dividends would be insufficient to pay their share of taxes on the banks' income because of the capital conservation buffer is most likely to occur when the bank is adequately capitalized, but one or more of its risk-based capital ratios breach the capital conservation buffer requirements.

The revised definition of eligible retained income would assist in the ability of S-corporation banks to provide dividends to shareholders in order to meet their pass-through tax liabilities.

See https://www.fdic.gov/news/news/press/2020/pr20030a.pdf for more information.

Additional Resources

We know that there are questions and uncertainty about the potential impact of COVID-19.

The FDIC has issued two sets of frequently asked questions (FAQs), one for financial institutions and one for consumers. The FAQs address a variety of issues that may arise as financial institutions work with customers and communities affected by COVID-19:

- https://www.fdic.gov/coronavirus/faq-fi.pdf
- https://www.fdic.gov/coronavirus/faq-customer.pdf

Additionally, K·Coe Isom has set up a "COVID-19 Resources & Updates" page that sorts through the noise, and provides you with the official action items, guidelines, and resources your financial institution needs right now.

Sign up for our Virtual Town Hall sessions – for guidance and live questions on crisis planning, employee communications, lender discussions – everything that businesses are facing due to COVID-19.