



Mutual Alert

OCC Revisions to National Bank Subordinated Debt Rules Presages Changes to Rule Governing Federal Savings Associations Limiting Even Tier 2 Capital alternatives for Mutuals.

The OCC comment period for its interim final rule for the inclusion of tier 2 capital of subordinated debt is January 20th. This rule does not apply to federal mutual savings associations but it is impossible to believe the OCC will treat subordinated debt issued by federal associations any differently than those issued by national banks when it issues a rule for federals. The rule signifies the regulatory attitude toward alternative capital instruments i.e. there really aren't any that a reasonable investor would purchase. A review of the rule yields dramatic insight into how far the pendulum has swung against inclusion of alternative instruments in the Basel III era. For example, the debt would not be eligible as tier 2 if it is retired on anything but a straight line amortization schedule, contains covenants that mandate minimum capital, loan ratios or liquidity, prohibits acceleration in the event of a change of control regardless of how much the credit rating of the issuing bank is weakened. It contains a host of other restrictions which limit payment to investors..

For mutual banks it is clear that the OCC has no appetite for tier 1 alternative capital instruments as its requirements for tier 2 are so restrictive as to deter most issuances. However, in fairness to the OCC it is doubtful that any other federal banking agency has a different or more liberal view. Clearly, Congressional intervention will be needed to provide mutuals with any capital relief.