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February 25, 1988

ATTORNEY GENERAL OPINION NO. 88- 26

The Honorable J.C. Long
State Representative, One Hundredth District
State Capitol, Room 174-W
Topeka, Kansas 66612

Re: Banks and Banking -- Banking Code; Dissolution; Insolvency -- Definition of Insolvency

Synopsis: Title VIII of the Competitive Equality Banking Act of 1987 applies to certain federal banks, certain state banks which are members of the federal reserve system, and certain state non-member banks insured by the Federal Deposit Insurance Corporation, allowing those banks to amortize qualified agricultural loans over a seven-year period and to reappraise property acquired by the bank incidental to such agricultural loans. Regarding those state banks covered by the act, only the relationship between the bank and the appropriate federal agency is affected. The state statute defining insolvency, and the authority of the state bank commission to take over an insolvent bank, are not altered by the federal act. Title VIII was not intended to make an otherwise insolvent bank solvent. Cited herein: K.S.A. 1987 Supp. 9-1303; K.S.A. 9-1902, 9-1903; Pub. L. 100-86, Title VIII [codified at 12 U.S.C. § 1823(j)]; 12 C.F.R. Parts 35, 208.15, 324 (November 2-3, 1987).

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Dear Representative Long:

As Representative of the One Hundredth District, you have requested our opinion concerning Section 801 of the Competitive Equality Banking Act of 1987 (CEBA), Pub. L. 100-86, Title VIII [now codified at 12 U.S.C. § 1823(j)]. Specifically, you inquire about the effect of Title VIII on the state banking code definition of insolvency, found at K.S.A. 9-1902.

The effect of Title VIII is to allow agricultural banks to amortize certain loan losses and to reappraise real and personal property acquired by the bank in connection with an agricultural loan. Without this provision, losses would have to be written off against capital at the time the losses are recognized. By amortizing the loss over a seven-year period, the bank's capital is not subject to a sudden reduction as when the loss is recognized in a one-year period. For a general discussion of purpose, see 1987 U.S. Code Cong. & Admin. News at page 489.

An agricultural bank is defined by Title VIII as a bank, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC), located in an area with an economy dependent on agriculture, having assets of less than $100,000,000, and a portfolio of at least twenty-five percent of its total loans in qualified agricultural loans. The last requirement may be lowered if the state bank commissioner or appropriate federal banking agency deems the bank eligible. 12 U.S.C. § 1823(j)(4)(A). Regulations by appropriate federal agencies have been proposed under authority of 12 U.S.C. § 1823(j)(3). See, interim regulations, 12 C.F.R. parts 35, 52 Fed. Reg. 41959 (November 2, 1987) (Comptroller of the Currency); 208.15, 52 Fed. Reg. 42087 (November 3, 1987) (Board of Governors of the Federal Reserve System); and 324, 52 Fed. Reg. 41966 (November 2, 1987) (Federal Deposit Insurance Corporation). Each agency's regulations are substantially the same as those of the other agencies. The rules establish the procedures that banks are to follow for participation in the loan loss amortization program. The primary procedural mechanism is the submission of a proposal by the bank to the appropriate federal agency. The proposal must include, among other things, a list of loans and property reappraisals upon which the bank wishes to defer losses allowed by Title VIII, and a plan designed to achieve an acceptable level of capital by the end of the amortization period. See, interim regulations 12 C.F.R. §§ 35.7, 208.15(f), 324.7. If the proposal is accepted, then the bank is eligible for amortization of agricultural loans and reappraisal of property acquired incidental to making a qualified agricultural loan.

Title VIII makes reference to "appropriate" federal agencies. For federally chartered institutions, it appears that the statute is generic in the sense that it applies to all banking institutions regulated by the three federal agencies. Our concern, however, is limited to the effect the federal act has on state chartered banks. State banking institutions which are members of the federal reserve system submit the proposal to the district reserve bank pursuant to 12 C.F.R. Part 208, and nonmember banks which are insured by FDIC submit the proposal to the director of the bank supervision division of FDIC pursuant to 12 C.F.R. Part 324. As previously noted, the substantive provisions of parts 208 and 324 are parallel.

Once a proposal is accepted by the appropriate federal agency, the relationship between the banking institution and the federal agency is affected. The bank's financial condition can be restated for purposes of continued eligibility for federal reserve or FDIC membership. In addition, the bank's lending ability is increased so that future loans will not exceed federal lending limits. There is no requirement in the federal law that the state regulator abide by the terms of the proposal. On the other hand, there is nothing to prohibit the state regulatory agency from considering acceptance of the proposal. The applicability of the deferral on state statutes must be addressed by the individual state. 52 Fed. Reg. 41966.

As the provisions of Title VIII involve the relationship between the bank and the federal agency, it is our opinion that the federal law does not directly affect the definition of insolvency set forth in K.S.A. 9-1902. That definition determines the conditions upon which the bank commissioner may take over a bank. K.S.A. 9-1903. The state banking code does not delegate the responsibility of determining insolvency to FDIC. Rather, the determination is to be based on an examination by the state bank commissioner. The bank commissioner is authorized to accept a report of examination from FDIC in lieu of reports required by the banking code. K.S.A. 1987 Supp. 9-1303. Such exchange of reports is discretionary, however. It is therefore possible for the commissioner to declare a bank insolvent, even though the institution would not appear unsound to the appropriate federal agency.

Our opinion is supported by the intent of Congress that the provisions of Title VIII apply only to banks which are otherwise "fundamentally sound." Cong. Rec. S3941 (March 26, 1987). To be eligible for the loan loss amortization program, the bank must be economically viable. 52 Fed. Reg. 41967 (November 2, 1987), 42089 (November 3, 1987). In short, the federal act was not designed to make an insolvent bank solvent.

In conclusion, it is our opinion that Title VIII of the Competitive Equality Banking Act of 1987 applies to certain federal banks, certain state banks which are members of the federal reserve system, and certain state non-member banks which are insured by the Federal Deposit Insurance Corporation, by allowing those banks to amortize qualified agricultural loans over a seven-year period and to reappraise property acquired by the bank incidental to such agricultural loans. Regarding those state banks, only the relationship between the bank and appropriate federal agency is affected. The state statute defining insolvency, and the authority of the state bank commissioner to take over an insolvent bank, are not altered by the federal act. Title VIII was not intended to make an otherwise insolvent bank solvent.

Very truly yours,

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