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ATTORNEY GENERAL OPINION NO. 82- 68

Roy P. Britton
State Banking Commissioner
Suite 600, 818 Kansas Avenue
Topeka, Kansas 66612

Re: Banks and Banking -- Code; Powers -- Investments

Synopsis: Interest rate futures contracts and forward placement contracts are not securities for purposes of the state banking code. Hence, state banks may not participate in such contracts pursuant to the authority granted banks under the state banking code to acquire investment securities. Cited herein: K.S.A. 9-1101, K.S.A. 1981 Supp. 9-1715, K.S.A. 17-1252, K.A.R. 17-11-1, 17-11-2, 17-11-6, 12 C.F.R., §1.3.

* * *

Dear Commissioner Britton:

On your behalf, Carl R. Sandstrom, Assistant Bank Commissioner, has requested our opinion on whether interest rate futures contracts and forward placement or delayed delivery contracts can be considered investment securities which may be acquired by banks under the state banking laws. This question apparently arises because Kansas state banks, as do National banks, have been using interest rate futures contracts to hedge against interest rate fluctuations, and your office is concerned that there is no specific statutory authority for state banks to become involved in these contracts.

K.S.A. 9-1101(3) permits banks to buy and sell securities of or fully guaranteed by the United States. A futures contract represents "a commitment to purchase or sell a standard amount of the deliverable grade security at a specified price during a specified delivery month in accordance with the exchange rules regarding delivery procedures." Comptroller of the Currency Banking Circular - 79, issued March 19, 1980.

Forward placement contracts have been described as

"over-the-counter contracts for delayed delivery of securities in which the buyer (long) agrees to purchase and the seller (short) agrees to make a delivery of a specified security at a specified price for future delivery. Cash market transactions other than 'when issued' transactions, specifying delivery (settlement) in excess of thirty (30) days following the trade date shall be deemed to be forward contracts. Forward contracts are not traded on organized exchanges, the terms are not standardized, and the contracts can only be terminated by agreement of both parties to the transaction." Id.

From a comparison of this definition with the one for futures contracts, it can be seen that the underlying goods are the same, with the primary differences being that forward placement contracts are not traded on organized exchanges and the settlement date in forward placement contracts is generally at least 30 days after the trade date. Neither forward placement contracts nor futures contracts are guaranteed by or obligations of the United States. Therefore, these contracts cannot be regarded as securities of the United States within the contemplation of K.S.A. 9-1101(3).

Further analysis of this issue leads us to the conclusion that neither the futures nor forward placement contracts are securities at all and, as a consequence, are not securities of the United States, within the meaning of K.S.A. 9-1101(3), or investment securities, within the meaning of K.S.A. 9-1101(7) or (13).

While the Kansas Banking Code does not define the term "security," the Kansas Securities Act provides that:

"'Security' means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate or interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificates; thrift certificates or investment certificates, or thrift notes issued by investment companies; certificate of deposit for a security; certificate of interest in oil and gas royalties; leases or mineral deeds; or, in general, any interest or instrument commonly known as a

'security,' or any certificate of interest or participation in, temporary or interim certificate for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. 'Security' does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period."
K.S.A. 17-1252(j).

In our judgment, whether interest rate futures contracts and forward placement contracts are securities must be determined with reference to the foregoing definition, in the absence of any definition in the banking code. "Ordinarily, identical words or terms used in different statutes on a specific subject are interpreted to have the same meaning in the absence of anything in the context to indicate that a different meaning was intended." Williams v. Board of Education, 198 Kan. 115, 124, 125 (1967). In addition, the legislatively prescribed rules of statutory construction require that "technical words and phrases, and such others as may have acquired a peculiar and appropriate meaning in law, shall be construed according to such peculiar and appropriate meaning." K.S.A. 77-201, Second. We think there is little question that "security" is a technical term which has "acquired a peculiar and appropriate meaning" through its definition by the legislature in the Kansas Securities Act and its interpretation by the courts.

Moreover, insofar as K.S.A. 9-1101(3), (7) and (13) and K.S.A. 17-1252(j) relate to the same subject, they must be construed together as statutes in pari materia. "It is well settled, that different statutes relating to the same subject are to be construed together." Kansas v. Young, 17 Kan. 414, 417 (1877). And the fact that the Securities Act was enacted ten years after the banking code does not diminish the applicability of this principle. "'Statutes relating to the same subject, although enacted at different times are in pari materia and should be construed together.'" Thoman v. Farmers & Bankers Life Ins. Co., 155 Kan. 806, 810 (1942), quoting Morrill County v. Bliss, 125 Neb. 97, 249 N.W. 98.

Although the Kansas Supreme Court has not passed on the specific matter of whether interest rate futures contracts or forward placement contracts are securities, it has interpreted the definition of "security" in K.S.A. 17-1252, stating:

"Generally the term 'security,' which has no precisely defined legal definition aside from statutory provisions, has reference to written instruments, usually for the payment of money

or to evidence a debt, and being more than a mere promise of the debtor of a general liability on his part has as collateral to it a pledge of property or some additional obligation. By common usage, however, the term has acquired a much broader meaning. It is now generally used to refer to instruments for the payment of money, or evidencing title or equity, with or without some collateral obligation, and which are commonly dealt in for the purpose of financing and investment. Instruments, whether secured or unsecured, which are used for the purpose of financing enterprises and promoting a distribution of rights in or obligations of such enterprises, and which are designed as a means of investment, are termed 'securities.'" State v. Hodge, 204 Kan. 98, 103 (1969).

Since futures contracts and forward placement contracts are generally not used by banks for the purpose of financing their enterprises or promoting a distribution of rights of such enterprises, but rather as a means of "hedging," these contracts do not constitute securities under the above definition.

K.S.A. 9-1101(7) allows banks to buy and sell investment securities which are evidences of indebtedness, subject to certain limitations. K.S.A. 9-1101(13) permits banks to buy any type of investment security with the approval of the bank commissioner. An investment security is defined in K.A.R. 17-11-1 as

"a marketable obligation, i.e., it must be salable under ordinary circumstances with reasonable promptness at a fair value; and with respect to the particular security, there must be present one or more of the following characteristics:

"(A) A public distribution of the securities must have been provided for or made in a manner to protect or insure the marketability of the issue; or

"(B) Other existing securities of the obligor must have such a public distribution as to protect or insure the marketability of the issue under consideration; or

"(C) In the case of investment securities for which a public distribution, as set forth in

(A) or (B) above, cannot be so provided, or so made, and which are issued by established commercial or industrial businesses or enterprises, that can demonstrate the ability to service such securities, the debt evidenced thereby must mature not later than ten years after the date of issuance of the security, and must be of such sound value or so secure as reasonably to assure its payment; and such securities must, by their terms, provide for the amortization of the debt evidenced thereby so that at least seventy-five percent of the principal will be extinguished by the maturity date by substantial periodic payments: Provided, That no amortization need be required for the period of the first year after the date of issuance of such securities."

It is our understanding that futures contracts are traded in organized markets regulated by the Commodities Futures Trading Commission, which would make them "salable under ordinary circumstances with reasonable promptness." Furthermore, even though forward placement contracts are not traded in organized markets they, too, would seem to meet the prompt salability requirement, in light of the recent expansion of their use by firms in credit markets, including national banks. However, K.A.R. 17-11-2 states in part:

"All purchases of investment securities for the account of the bank must be of securities 'in the form of bonds, notes, and/or debentures, commonly known as investment securities'. . . ."

Although the forward placement and futures contracts meet the marketable obligation standard, they are not in the form of bonds, notes, and/or debentures as required by K.A.R. 17-11-2. Therefore, even though the "underlying good" or commodity is in the form of a bond or note, the instrument being sold is merely a contract to buy or sell that commodity and not an investment security which banks are authorized to purchase.

Furthermore, the definition of "investment securities" set forth in the Kansas regulations is similar to the one found in federal regulations. See, 12 C.F.R. §1.3(b). That definition, issued by the Comptroller of the Currency, has subsequently been interpreted by the Comptroller as excluding both futures contracts and forward placement contracts. (Comptroller of the Currency Banking Circular - 79, issued March 19, 1980.) The interpretation of the Comptroller need not bind us in interpreting Kansas regulations; however,

such an interpretation is persuasive. We also note that, notwithstanding this interpretation, the Comptroller has specifically authorized national banks to participate in financial futures contracts and forward placement contracts because, when used carefully, "the use of these contracts is considered incidental to banking." Id. Thus, pursuant to the Comptroller's interpretive ruling, national banks may participate in futures contracts and forward placement contracts as an incident to their general banking business.

Here, it is appropriate to note K.S.A. 1981 Supp. 9-1715, which provides in part:

"(a) In addition to any and all other powers heretofore granted to the state bank commissioner, the commissioner shall have the power to authorize any state bank or trust company to engage in any activity in which such bank or trust company could engage were they operating as a national bank at the time such authority is granted, including but without limitation because of enumeration the power to do any act, and own, possess and carry as assets, property of such character including stocks, bonds or other debentures which, at the time said authority is granted, is authorized under federal laws and regulations for transactions by national banks notwithstanding any restrictions elsewhere contained in the statutes of the state of Kansas. Upon receipt of a written request from any state bank or trust company, the commissioner shall exercise such power by the issuance of a special order therefor if such commissioner deems it reasonably required to preserve and protect the welfare of such an institution and promote the general economy of this state. A copy of each such special order shall be mailed to all state banks and trust companies."

The foregoing pertains to special orders applicable to particular banks, but subsection (b) of this statute contains similar authority to issue general orders applicable to all state banks. Arguably, these provisions vest in the bank commissioner the power to authorize state banks to purchase futures contracts and forward placement contracts, since national banks are engaged in that activity, pursuant to a comptroller's banking circular, a federal reserve board policy statement and an FDIC policy statement, all found at CCH Federal Banking Law Reporter, ¶98170. However, while we are unaware of any decisions of the Kansas Supreme Court or prior opinions of this office construing the scope and

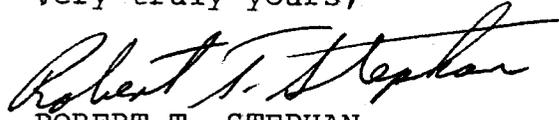
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extent of the general powers granted the Commissioner by this statute, that issue is not presented for our consideration.

Thus, we must conclude that the banking regulations discussed above preclude state banks from participating in futures and forward placement contracts. We also note that K.A.R. 17-11-6 prohibits the purchase of distinctly or predominantly speculative securities. From our understanding of futures and forward placement contracts, it would appear that improper use of these contracts increases rather than decreases risk of loss due to changes in interest rates; therefore, such fact may well prompt your determination that, even if these contracts were regarded as securities, they are improper investments because of their speculative nature.

In conclusion, it is our opinion that interest rate futures contracts and forward placement contracts are not securities for purposes of the state banking code. Hence, state banks may not participate in such contracts pursuant to the authority granted banks under the state banking code to acquire investment securities.

Very truly yours,


ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS


W. Robert Alderson
First Deputy Attorney General

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