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A BUILDING AND LOAN ASSOCIATION ESTABLISHING A SEPARATE RESERVE FOR LOSSES ACCOUNT— §§1151.33, 1151.50, 1151.51, 1151.52, 1151.53, R.C.

SYLLABUS:

In view of Sections 1151.33, 1151.50 and 1151.53, Revised Code, a building and loan association may not establish separate reserve for losses accounts, which accounts would be operated each independent of the other as, under those sections, only one reserve fund for the payment of contingent losses may be established; however, a building and loan association, as a matter of bookkeeping, may name within its reserve fund, a reserve for losses on qualifying real property loans, a reserve for losses on nonqualifying loans, a supplemental reserve for losses on loans, or other designation of reserve for losses, it being understood that the entire fund is available for any type of loss, and that the amount shown for any of the categories is available to pay other losses if necessary.

Columbus, Ohio, November 20, 1962

Hon. Andrew C. Putka, Superintendent
Building & Loan Associations, Columbus, Ohio

Dear Sir:

Your request for my opinion reads as follows:

“Sections 1151.33, 1151.50, 1151.51, 1151.52 and 1151.53 of the Revised Code relate to the establishment and maintenance

of a reserve fund for the absorption of losses by all building and loan associations chartered by the State of Ohio.

“Section 6 of the Revenue Act of 1962 (P.L.87-834, 87th Congress 2d Session (H.R. 10650), approved October 16, 1962) requires that the reserve fund carried by building and loan associations on December 31, 1962, be divided into several separate reserve for losses accounts on the books of the associations.

“I desire your opinion on the following question :

“May a building and loan association divide or segregate the reserve fund required by Statute into several separate reserve for losses accounts on its regular books of account?”

Section 6, Revenue Act of 1962 (P.L. 87-834, 87th Congress, 2d Session (H.R. 10650), approved October 16, 1962), reads, in part, as follows :

“SEC 593. RESERVES FOR LOSSES ON LOANS

- (a) *Organizations to Which Section Applies.* This section shall apply to any mutual savings bank not having capital stock represented by shares, *domestic building and loan association*, or cooperative bank without capital stock organized and operated for mutual purposes and without profit.

“* * * * * * * * *

“(c) *Treatment of Reserves for Bad Debts.*

(1) *Establishment of Reserves.* Each taxpayer described in subsection (a) which uses the reserve method of accounting for bad debts shall establish and maintain a reserve for losses on qualifying real property loans, a reserve for losses on nonqualifying loans, and a supplemental reserve for losses on loans. For purposes of this title, such reserves shall be treated as reserves for bad debts, but no deduction shall be allowed for any addition to the supplemental reserve for losses on loans.

(2) *Allocation of Pre-1963 Reserves.*

For purposes of this section the pre-1963 reserves shall, as of the close of December 31, 1962, be allocated to, and constitute the opening balance of—

- (A) the reserve for losses on nonqualifying loans,
 (B) the reserve for losses on qualifying real property loans, and

(C) the supplemental reserve for losses on loans.

“* * * * * * * *”

(Emphasis added)

I assume that you are concerned with whether an Ohio building and loan association may establish and maintain within its reserve fund a reserve for losses on qualifying real property loans, a reserve for losses on nonqualifying loans, and a supplemental reserve for losses on loans, so as to comply with the above provision of federal law.

Section 1151.33, Revised Code, reads as follows:

“A building and loan association may accumulate from its earnings *a reserve fund* for the payment of contingent losses and an undivided profit fund, both of which may be loaned and invested like other funds of the association.” (Emphasis added)

Section 1151.50, Revised Code, provides in part:

“The amount to be set aside to the reserve fund of a building and loan association for the payment of contingent losses shall be determined by the board of directors of such association, but in every permanent or perpetual association, at least five per cent of the net earnings shall be set aside each year to such fund until it reaches at least ten per cent of the total assets. *All* losses shall be paid out of such fund until it is exhausted. When the amount in such fund falls below ten per cent of the assets, it shall be replenished by annual appropriations of at least five per cent of the net earnings until it again reaches such amount. * * *”

(Emphasis added)

Section 1151.51, Revised Code, reads in part:

“* * * If the association acquires real estate as a result of default in a mortgage, whether by deed or by foreclosure, amounts paid out by it in court costs and taxes at the time such real estate is acquired may be charged to the reserve fund, and reconditioning costs after such real estate is acquired may be charged either to the reserve fund or to current operating expense, as determined by the board of directors. When any parcel of such real estate is sold by the association, the funds received shall be applied to the payment of sales expense, to the restoration of losses previously charged to the reserve or undivided profit funds, to the reduction of the book value of such real estate, or to current income, as determined by the board. * * *”

Section 1151.52, Revised Code, reads in part:

“After payment of expenses and interest, a portion of the earnings of a building and loan association to be determined by

the board of directors shall, annually or semiannually, be placed in the reserve fund for the payment of contingent losses. * * *” Section 1151.53, Revised Code, reads as follows:

“All losses of a building and loan association shall be met by the application thereto of the following, in the order listed:

“(A) The reserve fund provided for in sections 1151.33 and 1151.50 of the Revised Code;

“(B) The undivided profit fund provided for in sections 1151.33 and 1151.52 of the Revised Code;

“(C) The capital stock.”

On reading the above provisions of law, it is apparent that a building and loan association may establish only one reserve fund for the payment of contingent losses. Section 1151.50, *supra*, provides that *all* losses shall be paid out of the fund until it is exhausted. Section 1151.53, *supra*, is in accord with that provision in that it makes the *entire* reserve fund primarily responsible for *all* losses—that is, the reserve fund must be exhausted before the undivided profit fund, and capital stock, may be used to meet losses.

Accordingly, a building and loan association may not establish separate reserve for losses accounts, which accounts would be operated each independent of the others, as the money in the reserve fund must be available for *all* losses and can not be divided for certain purposes.

I see no bar, however, to a building and loan association, as a matter of bookkeeping, naming, within its reserve fund, a reserve for losses on qualifying real property loans, a reserve for losses on nonqualifying loans, and a supplemental reserve for losses on loans; but it must be understood that, in such a case, the entire fund would be available for any type of loss, and the amount shown for any of the categories would be available to pay other losses if necessary.

I express no opinion as to whether such a bookkeeping procedure would satisfy the federal law, as that is not a matter appropriately within my jurisdiction.

In conclusion, it is my opinion and you are advised that in view of Sections 1151.33, 1151.50 and 1151.53, Revised Code, a building and loan association may not establish separate reserve for losses accounts, which accounts would be operated each independent of the other as, under those sections, only one reserve fund for the payment of contingent losses may be established; however, a building and loan association, as a matter of

bookkeeping, may name within its reserve fund, a reserve for losses on qualifying real property loans, a reserve for losses on nonqualifying loans, a supplemental reserve for losses on loans, or other designation of reserve for losses, it being understood that the entire fund is available for any type of loss, and that the amount shown for any of the categories is available to pay other losses if necessary.

Respectfully,

MARK McELROY

Attorney General