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September 11, 1978

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ARIZONA ATTORNEY GENERAL

Mr. Walter C. Madsen
Superintendent of Banks
1601 West Jefferson Street
Phoenix, Arizona 85007

Re: 78-219 (R78-3)

Dear Mr. Madsen:

You have asked in a letter dated January 5, 1978, the following questions:

1. Is the guaranty capital of a State chartered savings and loan association available under Arizona law to be used for absorbing losses?
2. If the answer to the first question is "Yes," does A.R.S. § 6-428 prevent a State chartered savings and loan association from earmarking its guaranty capital as part of its federal insurance reserve account as required under 12 CFR 563.11?

All State chartered savings and loan associations are required to obtain federal deposit insurance (A.R.S. § 6-412) and therefore are subject to the requirements of federal law relating to such insurance. 12CFR § 563.11 as it relates to the insurance of accounts of State-chartered savings and loan associations provides in pertinent part as follows:

(a) Establishment of account. Each insured institution shall set up a federal insurance reserve account which shall be used solely for the purpose of absorbing losses. No insured institution may pay dividends or interest on savings accounts from its federal insurance reserve account. Any insured state-chartered institution, by specific and appropriate action, may permanently designate as part of its federal insurance reserve account all of any reserve account which under the provisions of state law is established for the sole purpose of absorbing losses. . . .

(b) Earmarking of net worth accounts. Any insured institution, by specific and appropriate

corporate action, and with the prior written approval of the corporation, may earmark as part of its federal insurance reserve account (i) any portion of any other reserve account which, by such corporate action, is made subject to charges for losses only, or (ii) any amount of pledged savings accounts, capital stock (where permitted by state law to be used for absorbing losses), capital surplus, contributed surplus, or retained earnings (Emphasis supplied).

With respect to your first question, A.R.S. § 6-424 provides as follows:

Shares of guaranty capital shall constitute a secondary reserve out of which losses shall be paid after all other available reserves have been exhausted, and shall have a par value of one dollar each or such greater amount as the articles of incorporation may prescribe; and such shares shall be:

1. Nonwithdrawable, except as provided in section 6-428, until all liabilities of the association have been satisfied in full, including payment of the withdrawal value of accounts.
2. Entitled to dividends only as provided in section 6-442.
3. Issued only upon cash payment of not less than the par value thereof, or in exchange for the withdrawal value of accounts, or in connection with a merger, sale of all assets, or conversion, or as stock dividends as provided in section 6-442.

Clearly this section provides that the guaranty capital of a State chartered savings and loan association is "permitted . . . to be used for absorbing losses." 12 C.F.R. § 563.11(b).

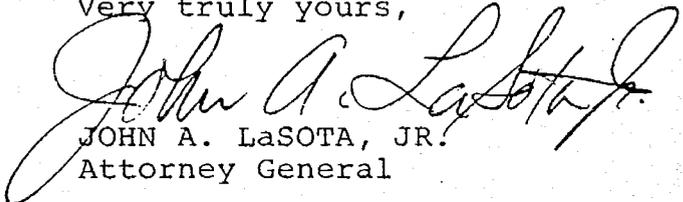
Your second question deals with the impact of A.R.S. § 6-428 on the availability of an association's guaranty capital for purposes of absorbing losses. A.R.S. § 6-424 provides that the association's guaranty capital is nonwithdrawable "except as provided in section 6-428." A.R.S. § 6-428 provides that the board of directors of an association may propose an amendment to the articles of incorporation providing for the retirement of the guaranty capital. This form of reorganization

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can only be accomplished with the approval of the holders of at least two-thirds of the outstanding shares of guaranty capital and at least two-thirds or more of the total number of votes which all other members of the association are entitled to cast thereon. In addition, the reorganization can only be implemented if approved by the Superintendent of Banks. Finally, this section provides that where retirement of guaranty capital is made, the resulting capital of the association may be not less than the minimum initial capital which the association, if it were being organized, would be required to have under the provisions of this chapter concerning applicants and initial capital. A.R.S. § 6-428 does contemplate an additional use of the guaranty capital of an association other than as a reserve for losses, but it would be impermissible for the Superintendent to authorize the retirement of guaranty capital if to retire that capital would eliminate reserves required to meet that association's federal insurance reserve account requirement; which, in turn, would result in loss of insurance coverage. See A.R.S. § 6-412.

Accordingly, it appears to us that the guaranty capital account of a State-chartered savings and loan association is permitted by State law to be used for absorbing losses. A.R.S. § 6-428 does not prevent the association from earmarking it as part of an association's federal insurance reserve account pursuant to 12 CFR 563.11(b). We should note, however, that the answer to your second question involves the interpretation of a regulation of the Federal Home Loan Bank Board, and it is not inconceivable that the Board may take a contrary view.

Very truly yours,


JOHN A. LaSOTA, JR.
Attorney General

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