

Legislative Analysis



BANKS: REVISE BAD DEBT PROVISIONS

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House Bill 4743 (Substitute H-1)

Sponsor: Rep. Darwin Booher

House Bill 4749 (Substitute H-2)

Sponsor: Rep. Ed Clemente

Committee: Banking and Financial Services

First Analysis (4-7-09)

BRIEF SUMMARY: The bills would extend the time period by which a bank must write off a debt on which interest is past due and would require the bank to charge off only that portion not secured by collateral.

FISCAL IMPACT: The bills would have no fiscal impact on the Office of Financial and Insurance Regulation (OFIR).

THE APPARENT PROBLEM:

Current law requires banks to charge off certain debts that are six months past due unless the debt is well-secured (secured by collateral) and in the process of being collected. Until recently, the number of loans that banks were required to write off remained relatively small. Unfortunately, the credit crisis of the last few years, and its associated fallout, has resulted in banks having to write off a higher number of debts than usual. Each loan that must be written off reduces the available capital of a bank and so reduces the amount the bank may lawfully make available in new loans.

The Michigan Bankers Association and the Office of Financial and Insurance Regulation have been working together to address the concerns of the banks. One problem that can be easily addressed is the six month cap on loans being overdue. Banks are encouraged to work more closely with homeowners in danger of losing their homes to foreclosure, but six months is simply too short of a time frame in which to negotiate a workable solution. It has been suggested that this period be doubled.

According to the MBA, another problem faced by industry members is that bank examiners do not agree on what constitutes a collection being "in process." As a result, there is great disparity amongst examiners as to which loans must indeed be charged off at the end of six months and which can be put off a bit longer. Further, banks must write off the entire amount of the debt, even if there is collateral that once sold could pay off all or a portion of the debt. By comparison, credit unions have been allowed under their statute to charge off only the amount of debt not covered by the secured collateral. The banks request that their statute be amended to do likewise.

THE CONTENT OF THE BILLS:

With some exceptions, a bank is required to write off a debt on which interest is past due and unpaid for a period of **six months**. House Bills 4743 and 4749 would extend this time period to **12 months**.

In addition, charging off debts is not required if "debts are well secured and in process of collection or the debts constitute claims against solvent estates in probate."

The bills would instead specify that unless a debt constitutes a claim against a solvent estate in probate, a bank or savings bank would have to charge off to its allowance for loan and lease losses the **portion of the debt that is not well secured**.

House Bill 4743 would amend the Banking Code (MCL 487.14205) to apply to banks.

House Bill 4749 would amend the Savings Bank Act (MCL 487.3512) to apply to savings banks.

ARGUMENTS:

For:

According to the Office of Financial and Insurance Regulation (OFIR), the bills will afford banks and savings banks more time to work out overdue loans before being required to write them off. In light of the number of properties both in the residential and commercial market affected by the economy, extending the time period to 12 months could have a significant impact on reducing the number of properties entering foreclosure.

Secondly, the bills would eliminate the requirement that a loan be "in process of collection" to avoid a mandatory charge-off. Reportedly, there is great disparity in interpretation of this phrasing by bank examiners. In addition, the bills will enable banks and savings banks to preserve capital, and therefore increase their capacity to offer new loans, by being able to deduct the value of any secured capital from the amount of the debt that must be charged off. Credit unions have been allowed to do so since 1986; it is time that banks and savings banks be given the same consideration.

POSITIONS:

A representative of the Office of Financial and Insurance Regulation testified in support of the bills. (4-2-09)

A representative of the Michigan Bankers Association testified in support of the bills. (4-2-09)

A representative of Farmers State Bank testified in support of the bills. (4-2-09)

A representative of Warren Bank testified in support of the bills. (4-2-09)

The Michigan Association of Community Bankers indicated support for the bills. (4-2-09)

A representative of the Michigan Credit Union League testified that the League is neutral on the bills. (4-2-09)

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Fiscal Analyst: Mark Wolf

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.