

ING & LOAN:

"Mutuality" necessary in all Building and loan plan of stock.

11-17  
November 15, 1933.



Hon. Ira A. McBride  
Supervisor  
Bureau of Building and Loan Supervision  
Jefferson City, Missouri

Dear Mr. McBride:

We are in receipt of the following communication from you:

"The American Home Building and Loan Association of St. Louis is requesting formal approval of a new plan of stock which they propose to issue.

In view of the fact that the plan is unique and differs somewhat from the ordinary plan of building and loan procedure, I hereby submit it to your Department for an opinion as to whether or not it conforms with the law and can be approved by this Department.

I am inclosing a letter received from the American Home Savings and Loan Association setting forth the salient features of the proposed plan of stock that you may have their arguments and understand their viewpoint on same."

The American Home Building and Loan Association letter referred to by you reads:

"Referring to conversation I had with you relative to the 15 year loan plan, the papers of which were sent to Jefferson City for your approval, I enumerate herewith a few of the salient points in favor of this plan as far as the borrower is concerned, likewise the Association.

From the borrowers point of view:

This plan we believe will fill a long felt want for a long time loan with small monthly installments.

It carries a rate of 6% interest, which rate seems to be the prevailing rate of interest in the minds of the average borrower.

It gives the borrower the benefit of a semi-annual reduction in the amount of the monthly payments.

It permits of monthly payments being credited semi-annually on the loan and for each \$100.00 reduction of principal one share of stock is canceled, making the borrowing shareholder only liable for approximately one share of stock for each \$100.00 unpaid on the loan.

From the Association's point of view:

This plan is an addition to and not a substitution for our present regular Building and Loan plan of loan.

It will, we believe, enable us to attract additional loans to the Association, thereby enabling us to keep our funds steadily employed.

It will fill what we believe a long felt want for a 6% interest loan.

It will attract, we believe, loans from borrowers who prefer to pay a specified rate of 6%, get a reduction semi-annually in interest rather than pay a higher rate of interest and receive as an offset semi-annual dividends.

It will enable us to regulate commission charges according to the money market conditions, whereas under present plan a stipulated rate is made, irrespective of money market conditions.

We believe that the future holds out the opportunity to attract money to us at lesser rates than we are now paying, which benefit we want to give to a certain extent to the borrowing shareholder and this plan will fill this need.

We are not doing away with our present plan and will continue it for those members who desire it. The new plan can be operated on the participating plan, that is, dividends not exceeding 3% will be allowed on monthly payments, providing the same are not withdrawn and applied to the loan but it is our wish that the borrower does apply it, even though by doing this he does not receive dividends on the small monthly payments, for in the long run he will be the gainer for it is our desire to give to the borrower the best possible plan which safety and fair dealing will permit.

We have gone over this plan of loan and we can see no objectionable features to it and we sincerely trust that your office as well as the Attorney General, to whom you submit the plan, will approve same immediately so that we can put the plan on the market by September 1st.

We are enclosing herewith schedule for this plan of loan showing how interest will be reduced as loan is being paid off."

The schedule appended to the American Home Building and Loan Association's letter, shows in part the following:

"Schedule for 15-year New Loan Plan at 6% interest and Monthly Payment on account of dues of \$5.00 per month. Dues to be withdrawn semi-annually on the 15th day of February and August and applied direct to the loan, interest for succeeding months to be adjusted accordingly.

Dues	Interest	Withdrawn	Amount of Loan
5.00	5.00		1000.00
5.00	5.00		
5.00	5.00		
5.00	5.00		
5.00	5.00		
5.00	5.00		
		30.00	970.00
5.00	4.85		
5.00	4.85		
5.00	4.85		
5.00	4.85		
5.00	4.85		
5.00	4.85	30.00	940.00

5.00	4.70		
5.00	4.70		
5.00	4.70		
5.00	4.70		
5.00	4.70		
5.00	4.70	30.00	910.00
Etc."			

And further,

"5.00	.80		
5.00	.80		
5.00	.80		
5.00	.80		
5.00	.80		
5.00	.80	30.00	130.00
5.00	.65		
5.00	.65		
5.00	.65		
5.00	.65		
5.00	.65		
(15th year) 105.00	.65	130.00	0.00"

Other papers submitted include:

- (1) Copy of the non-negotiable promissory note.
- (2) Copy of "installment stock" to be used.
- (3) Copy of by-laws.

1. The non-negotiable note contains among other things the following:

"The undersigned promises to pay to the \* \* \* \*, on or before 15 years after date, the principal sum of \* \* \* \* \* Etc."

Also,

"The undersigned hereby requests that dues and dividends credited on the shares shall be applied on the 15th day of February and August to reduce the principal sum, which the Association hereby consents to do; interest for subsequent months to be adjusted."

Further,

"Upon final payment of the entire indebtedness, the shares pledged shall be canceled and the value may be applied as a credit on this note."

Also,

"For each \$100.00 reduction of the loan one share of the stock pledged shall be canceled."

2. The "installment stock" contains, among other things, the following:

"and agrees to pay \_\_\_\_\_ Dollars  
and \_\_\_\_\_ Cents as dues for one  
hundred seventy nine months and balance  
\_\_\_\_\_ Dollars and \_\_\_\_\_  
Cents as dues in one hundred eighty  
months on the shares represented by this  
certificate, less deductions, if any,  
and dividends credited thereon, equal the  
par value of One Hundred Dollars (\$100.00)  
per share, then the shares shall be deemed  
to have matured."

Also,

"Dues paid on these shares and dividends credited may be withdrawn on the fifteenth days of February and August to be applied as a credit on the loan in connection with which these shares are assigned and pledged but if not withdrawn the same shall be entitled to participate in the dividends declared by the Board of Directors at a rate not exceeding 3% per annum."

Also,

"For each \$100.00 reduction of the loan one of the shares of stock pledged shall be canceled."

3. The by-laws provide in part (page 15):

"The capital stock of the association may be issued in INSTALLMENT STOCK, PRE-PAID STOCK and FULL PAID STOCK, in such classes, in such amounts and at such times as the Board of Directors may deem advisable, but no monthly payment INSTALLMENT STOCK shall be issued, the estimated maturity of which shall be for a longer period than fifteen years, nor shall any withdrawal or membership fee be charged on any monthly payment INSTALLMENT STOCK greater in amount than two per cent of the par value thereof, exclusive of any reduction in dividend rate as may be provided in the certificate, if the stock represented by such certificate is withdrawn prior to maturity. The difference between the estimated rate of dividend, if carried to maturity, and the earnings allowed as provided in any certificate issued, shall in no way be considered a withdrawal fee. The par value of each share shall be One Hundred (\$100.00) Dollars."

And further,

"When payments, less deductions, if any, and dividends credited thereon equal the par value of any share, then such share will be deemed to have matured."

And further, page 19:

"The dividends so declared shall be credited as of the last day of February, or August, as the case may be, provided, however, unless otherwise stipulated in the certificate of stock, the amount entitled to participate in dividends shall be the par value of Full Paid shares, and the book value of all Installment shares,"

Further, page 20:

"All dividends credited on Installment stock and Prepaid stock unless withdrawn shall thereafter form a part of the capital invested on account of such shares for the purpose of division of future profits unless otherwise provided in the certificate of stock."

I.

Thus, from the above, it is readily ascertained that if one borrows (say one thousand dollars), such borrower repays said amount together with 6% interest on unpaid balances. The borrower never participates in the dividends; neither are such applied toward the reduction of the loan for the reason that semi-annually, to-wit, on the 15th day of February and August the amounts paid as dues are applied on the loan and when one hundred dollars is paid on the loan one (\$100.00) share of stock is canceled. (Note By-laws, page 19: "The dividends so declared shall be credited as of the last day of February, or August, etc., \* \* \*, the amount entitled to participate in dividends shall be the par value of Full Paid shares, and the book value of all Installment shares,") Thus the shares of stock would have no book value at any time. It is simply a straight loan plan; the borrower paying back dollar for dollar and the company receiving back dollar for dollar loaned together with 6% interest on amounts due on loan. The stock transaction is a fiction. It is just as stated in the association's letter, supra:

"It will attract, we believe, loans from borrowers who prefer to pay a specified rate of 6%, get a reduction semi-annually in interest rather than pay a higher rate of interest and receive as an offset semi-annual dividends."

This plan is similar to what is described by Joseph H. Sundheim in his book, *Sundheim Building and Loan Associations*, Third Edition, page 18, as the "Reducing Payment Plan", in which he says:

"Under this plan the stock payments of the borrower are applied at regular fixed periods on account of the principal of his loan. At

the end of each fiscal period the borrower is charged with accrued interest and premium (if any) and given credit for all payments made, and the remainder is a new principal account for the next fiscal period."

We emphasize this,

"It will be seen that under this plan the membership of the borrower is a mere fiction, and should losses occur, or the association become insolvent, the borrower, having no stock credits, all having been applied to reduce his debt, he escapes that liability, and the entire burden must be borne by the saving members."

And further,

"This plan is legal under present legislation in nearly every jurisdiction in the United States as the technical requirements of membership are complied with."

We shall hereinafter determine whether or not this proposed plan is legal under the Missouri statutes.

## II.

"As stated in the cases before referred to, these building and loan associations are peculiar. They are conducted entirely on the mutual plan. The stockholders are members, not only in the usual sense of stockholders, but are partners with each other; the corporation is in the nature of a co-operative association."

Layton v. Hough, 169 Mo. App. 213, 1. c. 227.

"As it is sometimes stated in the statutes relating to, and in the charters and constitutions of, building and loan associations, the principal object of a building and loan association is to create a loan fund for the benefit of its borrowing members, the underlying ideas being that, by means of the system

of small periodical payments provided, people of limited means will be enabled to become the owners of homes, and thrift, economy, and good citizenship will thereby be promoted. By reason of these favorable results attending the operation of these associations and their beneficent purposes, they have, especially before they attained their present tremendous growth, been favored and granted special privileges by the various legislatures, such as permission to charge high rates of interest and exemption from taxation. However, with the growth of these organizations, evils have crept in, the privileges granted have in many instances been abused by unscrupulous officer, and, in recent years, the courts have been compelled to subject their transactions to closer scrutiny.

"Building and loan associations are peculiar corporations in that, at the inception, a share therein has only a nominal value, and payment therefore is made at the end, rather than at the beginning, and in that the capital may be diminished at the will of the stockholder by his withdrawal. While it may be stated generally that their basic and essential principle is mutuality, and that they are neither corporations nor partnerships to the fullest extent, the courts have found it difficult and practically impossible to qualify them accurately with other bodies."

9 Corpus Juris, pp. 920, 921 and 922.

182:

Observe part of Section 5593, Laws of Missouri, 1933, page

"Any corporation heretofore organized or now existing under the laws of this state relating to 'mutual saving fund, building and loan associations,' and any corporation organized in pursuance of the provisions of this article shall have all the powers provided for in this article, and the object of such corporation

shall be the accumulation of a capital in money, to be derived from payments by its members in periodical installments or otherwise, at such time and in such manner as shall be provided in the by-laws, and from the profits and accumulation arising from the investment of such payments."

In *Kansas City v. Mercantile Mutual Building & Loan Association*, 145 Mo. 50, l. c. 52, the court said:

"The property of building and loan associations is excepted from assessment and taxation by state law; that law providing for the assessment and taxation of such corporations by assessing the shareholders on their shares, and from them collecting the tax."

See Section 9768 R. S. Mo. 1929.

In *Bertche v. Equitable Loan and Investment Association of Missouri, et al*, 147 Mo. 343, l. c. 357 et seq., the Supreme Court, en Banc, said:

"If the statute governing building and loan associations, and the by-laws passed in conformity therewith, fixed no definite or arbitrary period at which the shares shall reach their par or maturity value, for a greater reason the association, a mere creature of the statute, can not fix an arbitrary period of one hundred months or any other time within which the shares of its members shall reach maturity.

"The law governing the formation of building and loan associations contemplates a scheme for paying the capital stock in instalments, so long as such periodical payments, taken in connection with its other income arising from fines, dues, interest and profits, are necessary in order to bring the stock up to par. This value represents the amount which the shares are expected to be worth, when, together with the profits upon investments, etc., it has accumulated to the amount contemplated at

the outset. The actual value of the share may be very small indeed during the first years of the association's existence. But the par value is fixed from the beginning. The association may be said to have accomplished the purpose of its organization when by the periodical payments made by its members, and the gains therefrom, each member has paid up to the amount fixed by its charter. (Endlich on Bldg. Assn's (2 Ed.), sec. 12.)

"It is a well settled proposition that the transaction between the association and its members is not a loan in a direct sense of the word, but only a prepayment or advancement to the shareholders of that to which he will ultimately be entitled."

And further,

"Endlich on Building Associations (2 Ed.), section 331, in speaking of the advancements of the association to its borrowing members, thus states the rule: 'as to the repayment of the principal, the design is most simple. The member, bound by his original contract with the association to make stated periodical payments of fixed amounts, strengthens his undertaking, to the greater security of the association which has parted with its funds to him . . . . by mortgaging his property as a pledge for such discharge to the end of the society's existence . . . . The member, mindful of the impossibility of evasion, continues to pay his regular dues. These, together with all similar payments made by the other members, and together with all the revenues from whatever sources flowing into the society's coffers, are added to the common treasury and again made the means of securing new profits, until the period arrives when the association is ready to wind up. The shares, his own interest in the society's accumulations, have now reached their contemplated value. But the borrower has anticipated that result, and in so doing has given the association the right to make itself whole, to reimburse itself not only

for what it has given him, but also for what he has agreed to add to that amount by way of premium offered, out of the sum standing to his credit as a member of this society. That sum is necessarily the amount he has received, plus the premium he has bid. The society appropriates this and the principal is repaid.'

"Again at section 338, the same author says: 'Whatever is paid by the borrower by way of premium, interest, dues, fines, etc., becomes a portion of the common fund, and being reinvested adds its profits to the great bulk in which he has a proportionate interest; and these being again reinvested, and so on ad infinitum, continue to swell the assets of the association until in due course of time, distribution can be made, and advanced members may be relieved of their obligations. Thus the borrower himself profits by his own payments.'

"The question as to the rights and obligations of the stockholders and the association has received much consideration of late in several of our sister States, and the trend of the more recent decisions is that any contract made by such an association in contravention of the statute and its by-laws is ultra vires and void.

"All members must participate equally in the profits and bear the losses, if any, in the same proportion. (Note the paragraph in the Association's letter, to-wit: 'It permits of monthly payments being credited semi-annually on the loan and for each \$100.00 reduction of principal one share of stock is canceled, making the borrowing shareholder only liable for approximately one share of stock for each \$100.00 unpaid on the loan.') This is the fundamental law of building and loan associations organized under the different statutes throughout the Union. The provisions in the borrower's notes and deeds of trust sought to be released, to the effect that the shares of stock pledged to secure their payment shall reach their full par value at the end of one

hundred months and the securities canceled and satisfied regardless of the earnings of the association, is clearly subversive of the legislative scheme governing building and loan associations and contrary to the clear letter and spirit of our statutes. The plan which seems to have been adopted by the association in respect to the loans in question is glaringly prejudicial to the non-borrowing members, and its enforcement will work a great injustice and hardship. Besides it would be inequitable and unfair. The rights of the borrowers must be determined from the standpoint of their relation to the non-borrowing stockholders."

And further,

"The association being organized under a mutual plan must treat all of its members equally, and any contract whereby one stockholder obtains greater share of profits than another would be violative of the principle of mutuality between the stockholders. The plainest principles of justice and honesty clearly forbid that one class of stockholders equally meritorious should be compelled to suffer that others may profit thereby. In the last reported case to which we have been cited on the subject, King v. International Bldg. Loan & Inv. Union, 170 Ill. 135, the court there holds, that a building and loan association, organized and based on the mutual plan, requiring subscription to its capital stock to be made in periodical payments, which should continue until the payments, together with the earnings of the association should equal the full face value of the shares, has no authority to issue a certificate of stock wherein it agrees to pay the subscriber the full face value of each share at the end of six years, on payment of seventy-five per cent per month on each share during said period. In the case of Wierman v. International Bldg., Loan & Investment Union, 67 Ill. App. 550, the appellate court of Illinois held that a building and loan association is a mutual company and bound to treat its members equally, and any contract made by such association in contravention of such mutuality is ultra vires and void. The the same effect is Baltimore B. & L. Ass'n v. Powhatan Imp. Co., 39 Atl. Rep. 274."

In *Williams v. Verity*, 98 Mo. App. 654, l. c. 659, the court said:

"It is contended by the assignee that a building and loan association can not arbitrarily fix any period when its shares shall mature, and that a borrowing stockholder is not entitled to have a deed of trust, given by him to secure the payment of his monthly dues, released until such dues are paid and the earnings thereon bring his stock to par; and that therefore the action of defendant in fixing the number and amount of the monthly dues to be paid on the Coulter stock by the plaintiff to bring such stock to par and to entitle her to a release of the deed of trust as to lot 2, as stated by its secretary in his letter to Rowley & Owen, was arbitrary and in excess of its authority. As was said by us in another case, there are only two ways by which a borrowing stockholder, under the statute of 1889, may be entitled to have released a deed of trust given to secure the payment of his monthly dues, one of which is when he repays the advance, as provided in section 2813, and the other, when the payment of monthly dues on his stock and the profits of the business of the association together become sufficient to mature such stock, or bring it to par. *Caston v. Stafford*, 92 Mo. App. 182. And when such an association fixes and declares that the payment of any given number and amount of monthly dues will bring the shares of its stockholder in the association to par, it acts in excess of its authority; for whether or not any specified number and amount of monthly payments would bring its stock to par must depend on the earnings thereon, which, of course, is an element of uncertainty in the business that renders it impossible for it, or any of its officers, to determine in advance when its stock, or any part of it, will mature, or, which is the same thing, reach par. It seems clear to us that the act of the building

association in determining and representing that it required the payment of forty-six monthly payments of \$9 each to bring the Coulter stock to par, and to thereby authorize a release of the deed of trust, was arbitrary and capricious--ultra vires."

See also, *Caston v. Stafford*, 92 Mo. App. 182.

Section 5603, Laws of Missouri, 1931, page 154, provides in part:

"Each shareholder shall pay to said corporation at or before each stated meeting of the directors or at such time as may be provided in the by-laws as a contribution to the capital thereof the sum fixed as dues for each and every share held by him, until each share shall, under the provisions of this article, reach the ultimate value thereof:"

Section 5601, Laws of Missouri, 1931, page 152, provides in part:

"A shareholder may repay a loan at any time upon application to said corporation, upon such terms and conditions as may be prescribed in the by-laws of the association;"

Page 126, *Sundheim on Building and Loan Associations*, says:

"The statutes, in most jurisdictions, provide that, 'a borrower may repay a loan at any time,' and while not expressly stated, no doubt the association would be compelled to accept part payment at any time, but this question has never been raised as it is the universal custom to do so, \* \* \* \* \* the borrower is not compelled to cancel his stock; he may repay his loan in full and retain his stock."

Note this provision in the "Instalment Stock", supra:

"For each one hundred dollar reduction of the loan one of the shares of stock shall be canceled."

## III.

While the proposed plan apparently meets the technical requirements of membership so as to fall within the provisions of the statutes, yet, when analyzed, the "mutuality" feature is not present, hence ultra vires. We have hereinbefore set out what the object and duties of building and loan associations are and consist of, and quoted at length from various texts and cases to illustrate the fact that a contract that permits one class of stockholders to obtain an advantage over other stockholders would be ultra vires. We conclude that the plan proposed is ultra vires and assign some of the reasons therefor:

- (1) It is simply a straight loan plan.
- (2) The borrowing member does not participate in the dividends so that the dividends may be applied in reduction of the loan.
- (3) Non-borrowing members obtain the benefit of interest (and earnings of such) paid by holders of proposed class of stock, which gives non-borrowing members an advantage over members of such stock.
- (4) Insolvency:
  - (a) In event of insolvency uncanceled shares of stock owned by borrowers are subject to liability.
  - (b) Non-borrowing members must bear entire loss of canceled shares.
  - (c) Does it not attempt to create a debtor and creditor relationship?
- (5) The certificate of stock fixes a definite maturity date, to-wit, fifteen years.
- (6) The proposed plan is a substitution of present building and loan plan relative to loans to that of loan companies.
- (7) Other reasons not specifically listed.

Nov. 15, 1933.

Therefore, in answer to your inquiry, "I hereby submit it to your Department for an opinion as to whether or not it conforms with the law and can be approved by this Department.", our answer is in the negative.

Very truly yours,

James L. HornBostel  
Assistant Attorney-General.

APPROVED:

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ROY McKITTRICK  
Attorney-General.

JLH:EG