BANKS; Restrictions on loans: Banks may not, either directly or indirectly, by any means loan to one person a sum greater than 20% of the capital stock actually paid in and surplus fund of such bank if located in any city having a population of less than 100,000 and over 7,000.

SUPPLEMENT TO OPINION #64
DATED MARCH 29, 1946.

June 11, 1947

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FILED
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Honorable H. G. Shaffner
Commissioner of Finance
Jefferson City, Missouri

Dear Mr. Shaffner:

Since our recent conference concerning the request of the Columbia Savings Bank, Columbia, Mo., through the law firm of Clark, Boggs, Peterson & Becker, to obtain a modification of our opinion #64, rendered to Honorable M. E. Morris, March 29, 1946, or at least to indicate if, under their construction of Section 7952, R.S. Mo. 1939, as re-enacted, Laws of Missouri, 1943, page 994, Section 1, we may answer in the affirmative the following question appearing as paragraph two in the opinion of the said law firm to said Columbia Savings Bank of date May 4, 1946, construing said Section 7952, which question is as follows:

> "May a bank, subject to the provisions of Section 7952, located in a city of approximately 19,000, acquire by purchase or discount from a dealer in machinery, notes secured by chattel mortgages executed by customers of said dealer, endorsed with recourse, which in the aggregate exceed twenty per centum of the capital stock and surplus of said bank?"

The question submitted does not directly come within the compass of our former opinion #64. There, the question was:

> "* * * whether the value of acceptance drafts as mentioned and defined in said sub-section (e), page 997, Laws of Missouri, 1943, are excepted

> from the value given evidences of debt mentioned and defined in sub-section 1 of said new Section 7952, as paper not constituting any part of the percentage value a bank may lend any one person, when, for instance, a sight draft is issued along with a shipper's order bill of lading, and the draft for the full value of the amount of the shipment. * * * ".

Here, the question is whether a bank may acquire from one dealer, by purchase or discount "* * * notes secured by chattel mortgages executed by customers of said dealer, endorsed with recourse, which in the aggregate exceed twenty per centum of the capital stock and surplus of said bank."

The writer has reviewed said opinion #64, and also has carefully read the opinion of Honorable William H. Becker, a member of the law firm of Clark, Boggs, Peterson & Becker, to Columbia Savings Bank of date May 4, 1946. If, as might be the case, counsel for said bank takes the position that said opinion #64 is in disagreement with their conception of sub-section 1 of Section 7952, in that said opinion #64 holds that a bank may not lend to one person by discount or purchase of the securities or evidences of debt named in said section in excess of the percentage of the "capital stock actually paid in and surplus fund of such bank", we adhere strictly to our said opinion #64.

Said Section 7952, R.S. Mo. 1939, as amended, Laws of Missouri, 1943, page 994, by the enactment of a new Section 7952, was in turn repealed by Senate Bill #189 passed by our Legislature in 1945. Said sub-section 1 of Senate Bill #189 now appearing in Laws of Missouri, 1945, page 919, l.c. 920, is almost identical with sub-section 1, Laws of Missouri, 1943, page 994, l.c. 995. The sense, the objects and purposes of the two sub-sections are identical. That part of sub-section 1 of said Section 7952 pertinent to the question here is as follows:

> "* * * A bank subject to the provisions of this article:
>
> "1. Shall not directly or indirectly lend to any individual, partnership, corporation, or body politic, either by means of letter of credit, by acceptance of drafts or by discount or purchase of notes, bills of exchange or other obligations of such individual,

> partnership, corporation or body politic an amount or amounts in the aggregate which will exceed * * * * * * * * * * * * twenty (20) per centum of the capital stock actually paid in and surplus fund of such bank if located in a city having a population of less than one hundred thousand and over seven thousand; * * * ".

We note especially that in the question submitted, it is said that the notes mentioned would be "endorsed with recourse".

The word "recourse" is defined in Webster's International Dictionary, Second Edition, page 2081, as an intransitive verb in definition 1: "to return; revert".

Definition two, the same page, same volume: "to have recourse; to resort".

Black's Law Dictionary defines the term "without recourse" as making a qualified or restricted endorsement of a bill or note, and states:

> "by these words the endorser signifies that, while he transfers his property in the investment, he does not assume the responsibility of an endorser."

If, then, one assigns a bill of any sort "without recourse" it means that he is without any responsibility as an endorser. The converse would undoubtedly be true when and where a bill is assigned "with recourse". Such an assignment would create a responsibility and liability upon the assignor as an endorser guaranteeing the integrity of the bill.

Volume I, Bouvier's Law Dictionary, at the bottom of page 881, left column, under the subject of "discount", says:

> "There is a difference between buying a bill and discounting it. The former word is used when the seller does not endorse the bill and is not accountable for its payment". (20 N.C. 350).

We believe that where the dealer - as in the example submitted by Mr. Becker - endorses the notes made to him by

his customers for "merchandising" to the bank "with recourse", such notes would become, and are, his individual debt and obligation to the bank, and is, in fact, even though in form it might appear to be a purchase, a loan by discount, and comes definitely within the inhibition of paragraph 1 of said Section 7952, Laws of Missouri, 1943, page 994, l.c. 995, which is as follows:

> "A Bank subject to the provisions of this article:
>
> "1. Shall not directly or indirectly lend to any individual, partnership, corporation, or body politic, either by means of letters or credit, by acceptance of drafts or by discount or purchase of notes, bills of exchange or other obligations of such individual, partnership, corporation or body politic an amount or amounts in the aggregate which will exceed fifteen (15) per centum of the capital stock actually paid in and surplus fund of such bank if located in a city having a population of one hundred thousand or over; twenty (20) per centum of the capital stock actually paid in and surplus fund of such bank if located in a city having a population of less than one hundred thousand and over seven thousand; and twenty-five (25) per centum of the capital stock actually paid in and surplus fund of such bank if located elsewhere in the state, with the following exceptions: * * * ".

A loan is defined in the leading text authority in this country, Corpus Juris, Volume 38 of that work, page 126, as follows:

> "Loan of money. A contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which he borrows; the delivery by one party and the receipt by the other party of a given sum of money, upon an agreement, express or implied, to repay the sum loaned, with

> or without interest. If such is the intent of the parties, the transaction will be considered a loan without regard to its form."

The case cited and quoted in the brief prepared by Mr. Becker, Meserole Securities Co. Inc. vs. Cosman et al., reported in 170 N.E. (N. Y.) 519, does not, we believe, support the view expressed by Mr. Becker that the transaction identified would be a purchase. The case at best is of doubtful applicability to the question being considered here. That was a case in which the question was whether the plaintiff corporation was authorized to "discount" notes. Here, we have the question of what the effect may be of discounting notes under our statutes, and not the construction of what constitutes lawful authority to discount paper. The question here is whether an endorsement to the bank by the payee "with recourse" and under discount would be a loan or a purchase. It must not be overlooked that said sub-section 1 of said Section 7952, Laws of Missouri, 1943, page 995, prohibits excessive loans by "purchase" of notes and other obligations.

Of course the intention of the parties to the transaction would, like any other contract, furnish the true basis for the construction of the effect of the contract, unless contrary to some statutes or against public policy. Their intention would not necessarily be determined by what they might say, but would be governed by what the facts of the case were, and what the ultimate effect of their agreement was under the application of the law to like facts and circumstances having received previous judicial determination. But how may we arrive at the true view of their intention? We believe it would be by an analysis of the facts of the case, and applying the text of the law and the decisions of the Court to such conditions. Here is a dealer who has automobiles to sell, it is said. He does sell them. He took notes for his sales. He cannot carry the notes because he must pay the maker or distributor. The bank and the broker both, we assume, know this fact. The banker says: "You are all right, but we happen to know that some of your customers who, while not insolvent, are not very prompt to pay. We will take these notes and discount them if you will endorse them 'with recourse'". The dealer agrees, endorses the notes with recourse, and the money is delivered to him or placed to his credit in the bank. What, then, was the

consideration for the advancement of the money by the bank? The answer must be, we think, the endorsement by the dealer "with recourse" upon him to pay any or all of the notes his customers fail to discharge, thus making it his own contract to pay if his customers did not pay.

It is, therefore, we think, shown thereby, that their intention was, and would be, construed to mean that the transaction should be a loan by discount, just as if the dealer were borrowing the money from the bank and had put up his customers' notes as collateral. We think it just as simple as that.

We think that when parts of the decision quoted by Mr. Becker, 170 N.E. 519, supra, preceding and following the part Mr. Becker quotes, are read, the decision will support our view that such a transaction would constitute a loan.

The decision cited and quoted by Mr. Becker in addition to the part quoted in his brief, l.c. 521, 522, states:

> "* * * Undoubtedly definitions of the word 'discount' by lexicographers and economists may be found wide enough to cover every purchase of a debt or chose in action, yet in banking or finance it seems to have a meaning somewhat more restricted. Banks are not ordinarily permitted to speculate in the purchase of negotiable instruments made or indorsed by parties of doubtful financial responsibility. Banks of discount loan or advance moneys to the makers or holders of negotiable instruments, receiving at that time, by deduction from the sum loaned or advanced, the interest or compensation to be paid for the advance of the bank's money. See Jevons, Prim. Pol. Econ. 114.
>
> "Ordinarily perhaps the advance or loan is made by discount of negotiable paper created for that purpose and having no legal inception until delivered for discount. Sometimes the loan or advance is made to the maker, sometimes to an indorser, where the maker has signed the note for the accommodation of the borrower. If a bank loans or advances moneys to a customer upon an

> existing note indorsed by the customer upon deducting interest to the date when the note becomes due, the transaction may in form be a purchase of the note, for most practical purposes the transaction is the same as if the moneys advanced formed the consideration for the making of the note.

Also, we cite and quote, l.c. 523, of said decision, as pertinent to this question, the following:

> "* * * It is the function of a bank of discount to employ its funds in the form of loans or advances to its customers, receiving compensation in the form of interest upon the moneys loaned or advanced. Such loans or advances are made upon the credit of the customers, either with or without the credit of other parties in addition. If it makes such a loan or advance in the form of a discount of a bill or note, payable at a future date, it pays to the maker or holder the face amount of the instrument after deducting interest for the use of the money till the date when the instrument is payable. Where such payment by the bank constitutes the consideration for the execution of the bill or note, the transaction is, both in form and in fact, a loan. Where such payment is the consideration for the transfer of a pre-existing instrument the transaction is in form a purchase; yet in both cases the transaction carried on by the bank is part of its function to loan or advance moneys to its customers, deriving its profit from the receipt of interest in advance."

Of course a note, in order to be negotiable and disposable must be a pre-existing instrument. We may assume that the note, or notes, in this case, would be payable at a future date, since we cannot believe that any bank would accept, at all, notes, at discount, if they were past due, with the possible infirmities that might be attached to them after maturity.

The case cited - 170 N.E. 519 - does distinguish between a sale or a purchase and a discount in the disjunctive, because the plaintiff there had the right, under

its certificate of incorporation, to "purchase or sell property" as a brokerage enterprise, but did not have the right, so it is held in the case, to "discount" notes and evidences of debt, because discounting paper was the exclusive privilege of banks. Our statute prohibits both the purchase and discounting, either conjunctively or disjunctively, if either, or both, respectively, becomes, or become, a loan by the bank in excess of the percentage ratio set up in said sub-section 1 of said Section 7952, Laws of Missouri, 1943, as amended in Laws of Missouri, 1945, page 919.

We believe a transaction, such as stated, either factual or hypothetical, as given by Mr. Becker would, whether as an ostensible purchase or as a discount, be a loan by the bank to the dealer, and being in excess of the 20% of the "capital stock actually paid in and surplus fund of such bank" would violate said sub-section 1 of said Section 7952, Laws of Missouri, 1943, page 995, and as amended in Laws of Missouri, 1945, page 919.

CONCLUSION.

It is, therefore, the considered opinion of this Department that our former opinion #64 correctly states the law as we then viewed it, and view it now, and we adhere to the principles and authority submitted in said former opinion.

Respectfully submitted,

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Assistant Attorney General

APPROVED:

J. E. TAYLOR
Attorney General

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