3698.

SUPERINTENDENT OF BUILDING AND LOAN ASSOCIATIONS—MAY CONSENT TO SALE OF PRIOR PARTICIPATING INTEREST BY A BUILDING AND LOAN ASSOCIATION—LIMITATION.

SYLLABUS:

Under the provisions of Section 9662, General Code, the Superintendent of Building and Loan Associations is authorized, in his discretion, to consent to the sale of prior participating interests by a building and loan association in obligations secured by mortgages on real estate owned by such association when it is made to appear that such sale is necessary for the purpose of paying the debts of the association or for the purpose of enforcing or protecting such association's securities and preserving its assets.

COLUMBUS, OHIO, October 26, 1931.

HON. THEO. H. TANGEMAN, *Director of Commerce, Columbus, Ohio.*

DEAR SIR:—Your letter of recent date is as follows:

"May we have your opinion on the following question:

May the Superintendent of Building and loan Associations consent to either or both of the following transactions:

(1) An Ohio Building and Loan Association owning first mortgages representing original loans made by it under Section 9657 of the General Code, proposes to sell with the consent of the Superintendent of Building and Loan Associations, prior participating interests in such mortgages, retaining subordinate interest therein,

(a) either for the purpose of liquidating loans owed by it and releasing similar mortgages pledged as collateral security for such loans, or

(b) for purposes other than the payment of a loan and/or the release of mortgages pledged as collateral security therefor, such other purposes being for the enforcement of or the profection of the company's securities and the preservation of its assets for the benefit of its depositors, creditors and members.

(2) If this may be done under either one or both of the foregoing conditions, may the result be accomplished by permitting the first mortgage representing the prior participating interest so sold to be taken by some party other than the building and loan association and the remaining subordinate interest retained by the building and loan association as a direct second mortgage.

The foregoing questions are based, of course, upon the assumption that under Paragraph (1) (a) the amount of the association's indebtedness is not thereby increased, the transaction being for the purpose of liquidating the association's obligation and releasing to it for the benefit of its depositors, creditors and members mortgages pledged as collateral therefor, which mortgages are now subject to sacrifice sale for the purpose of liquidating said loan.

It is our understanding that the net result as far as the association is concerned in any event under any of the foregoing stipulated

conditions will be the same though the mechanics of the transaction may vary in different cases and that the purpose in any case is to enforce or protect the company's securities and to preserve its assets for the benefit of its depositors, creditors and members either by liquidating loans and/or securing the return of excess pledged collateral and/or converting investments originally made as first mortgage loans into cash items in whole or in part."

Section 9657, General Code, to which you refer, authorizes building and loan associations to make loans upon obligations secured by first mortgage on real estate or any leasehold estate therein. Building and loan associations are not authorized to make loans secured by second mortgages on real estate.

Section 9662, General Code, sets forth some of the powers of building and loan associations in the following language:

"To buy but not to sell, except with the written consent previously granted by the superintendent of building and loan associations interest bearing obligations secured by real estate mortgages, which shall in all respects comply with, and be within the rules adopted for making mortgage loans by the corporation making such investments. Such mortgage investments may be held and reported as mortgage loans."

It may be contended that this authority to sell interest bearing obligations secured by first mortgages, with the consent of the Superintendent of Building and Loan Associations, relates only to such as are purchased by the association and not to such obligations secured by mortgage as have been acquired through the making of original loans. But since it is contemplated in this statute that these mortgage investments be held and reported as other mortgage loans, after acquisition, they are, I think, in the same category. Therefore, the authority to sell, with the consent of the Superintendent, interest bearing obligations secured by first mortgage, which have been purchased, cannot properly be said to exclude the authority so to sell a mortgage investment held as a result of an original loan.

Before considering then, the detailed facts which you present, it is necessary first to consider whether or not the Superintendent of Building and Loan Associations may consent to the sale of a part of such an interest bearing obligation or an interest in such a security. If this question may be answered in the affirmative, the question then remains of whether or not the consent of the Superintendent to such sale under the various circumstances set forth in your communication would constitute an abuse of the discretion vested in him by the legislature.

Considering this preliminary question, I have little difficulty in concluding that since the statute contains no provisions prohibiting such procedure, the authority to sell an interest bearing obligation secured by a mortgage on real estate, necessarily includes the authority to sell any interest in such obligation or any part thereof, and it is immaterial whether the interest sold in a given obligation is a prior or secondary interest, in so far as this power is concerned. The maxim that the greater contains in itself the less, has long been recognized. 15 Pick. (Mass.) 397; 1 Gray (Mass.) 366. See also Broom's Legal Maxims, 9th Ed. 121, where the author, speaking of this maxim, says:

"The maxim admits of familiar illustration in the power which a tenant in fee simple possesses over the estate held in fee; for he may either grant to another the whole of such estate, or charge it in any

> manner he think fit, or he may create out of it any less estate or interest; and to the estate or interest thus granted he may annex such conditions, not repugnant to the rules of law, as he pleases. 1 Prest. Abstr. Tit. 316, 377."

Coming then to the circumstances under which the Superintendent of Building and Loan Associations may, in the valid exercise of discretion, authorize the sale by a building and loan association of prior participating interests in obligations secured by mortgages on real estate, you present two situations: First, whether the purpose sought is the liquidation of debts owed by the association and the release of similar securities pledged as collateral; and, second, for the purpose of the protection of the company's securities and the preservation of its assests for the benefit of its depositors, creditors and members.

Where it is made to appear to the Superintendent of Building and Loan Associations that the sale of prior participating interests in such securities is made for the purpose of paying debts of the corporation lawfully contracted and releasing similar securities deposited as collateral to secure such debts, his consent may not, in my judgment, be said to contitute an abuse of discretion. Corporations generally have the power to convey or transfer any part or all of the property when necessary to pay debts lawfully contracted. *Stetson* v. *City Bank of New Orleans,* 12 O. S. 577; *Fletcher Cyc, on the Law of Private Corporations,* Vol. II, Page 2144.

The next situation which you present is one whereby it is made to appear that the sale of such prior participating interests is for the purpose of protecting the company's securities and preserving its assets.

Section 9655, General Code, defining some of the powers of building and loan associations, expressly provides that such a corporation shall have the power "To lease, acquire, hold, encumber, convey and rent such real estate and personal property as is necessary for the transaction of its business, or necessary to enforce or protect its securities." Obviously, even in the absence of the express power to "protect its securities" such financial institutions are charged with this duty, and the Superintendent of Building and Loan Associations is also charged with the same responsibility.

The legislature of Ohio has recognized the wisdom of deviating from the usual practice governing financial institutions when it becomes necessary to prevent loss upon debt previously contracted in good faith. Section 710-114, General Code, restricting the authority of banks in the lending of money, provides:

> "No bank shall loan money on the security or pledge of the shares of its capital stock; nor be the purchaser or holder of any such shares, unless such security or purchase be necessary to prevent loss upon debt previously contracted in good faith. Stock so acquired shall, within six months from the time of its purchase, be sold or disposed of at public sale on thirty days' notice from the superintendent of banks, and in default thereof the superintendent of banks may forthwith take possession of the property and business of such bank until its affairs be finally liquidated, as herein provided."

It is my opinion therefore that under the circumstances set forth in your first question, the Superintendent of Building and Loan Associations has authority to authorize a building and loan association to sell prior participating interests in obligations secured by mortgages on real estate.

You next inquire as to whether or not in order to consummate the foregoing transactions, the first mortgage may be sold and a direct second mortgage executed to the building and loan association. It is my view that this question may not be categorically answered. It is one which is dependent upon all the facts and circumstances surrounding a given case. It could well be argued that if a building and loan association may under the circumstances under consideration sell prior participating interests in mortgages, retaining subordiate interests therein, it makes no difference whether the transaction is consummated by executing a contract by which the association's mortgages remain as they are and the purchaser receives the payments first or whether the mortgages are turned over to a trustee, or whether the mortgages are rewritten and the purchaser of the prior participating interest receives a new first mortgage and the association selling such interest receives a second mortgage.

Section 9657, General Code, as hereinabove mentioned, precludes a building and loan association from lending money on second mortgages. The statute does not directly prohibit a building and loan association from borrowing money under such circumstances as might result in the association holding a direct second mortgage. It must be borne in mind, however, that the legislature did not contemplate a situation whereby building and loan associations shall have assets consisting in a substantial degree of second mortgages. This practice, while probably justified under some circumstances, should be carefully scrutinized by the Superintendent of Building and Loan Associations in granting the consent provided in section 9662, supra. The detailed method by which the purposes about which you inquire are effectuated is in the last analysis not controlling. The courts will universally look to the essence of a transaction rather than to the form.

It is assumed that the prior participating interests which are sought to be sold are to be sold at their face value and not at a discount. This opinion is predicated upon that assumption. Obviously, if a prior participating interest were sold at a discount, the assets of the association would be reduced and serious doubt might arise as to the power of the Superintendent to consent to such a transaction. It may be, however, that circumstances may arise whereby the sale of such an interest in a mortgage security at a slight discount, necessitated by a change in the money market, would be perfectly justified and in the best interests of the association, its depositors and members. There are numerous details which may arise as collateral to transactions such as are proposed which must, in the last analysis, rest with the sound discretion of the Superintendent. I shall not, in this opinion, endeavor to pass on such hypothetical matters. It is sufficient to say that extreme caution should be used by the Superintendent in the exercise of this discretion here under consideration, particularly for the reason that the wholesale disposition of prior participating interests in mortgage securities by building and loan associations affords an easy method to circumvent the statutory inhibition against lending money on second mortgage securities.

Specifically answering your questions, therefore, it is my opinion that under the provisions of Section 9662, General Code, the Superintendent of Building and Loan Associations is authorized, in his discretion, to consent to the sale of prior participating interests by a building and loan association in obligations secured by mortgages on real estate owned by such association when it is made to appear that such sale is necessary for the purpose of paying the debts of the association or for the purpose of enforcing or protecting such association's securities and preserving its assets.

Respectfully,
GILBERT BETTMAN,
Attorney General.