in force until rescinded or modified by the Public Service Commission or by law. Whether a rescission or modification of said order is indicated by a change of conditions occurring since its issuance is for the good judgment of the Commission.

OFFICIAL OPINION NO. 71

July 23, 1946.

Hon. Joe McCord, Director,
Department of Financial Institutions,
State House,
Indianapolis, Indiana.

Dear Sir:

I have your inquiry of July 3rd which reads as follows:

"The question has been raised as to the investment limit of state chartered banking institutions, under Section 173 of The Indiana Financial Institutions Act, in bonds issued by the Trustees of Indiana and Purdue Universities.

"Both universities contemplate building programs which will necessitate the issuance and sale of substantial amounts in mortgage bonds in connection with each unit, or building. The bonds will be self-liquidating from fees and operations, or a combination of both. Building programs have been financed in this manner in the past and each institution has bonds of this type outstanding at the present time. Indiana University also has some building bonds outstanding which were issued as general obligations.

"The Department, in its supervision of banking institutions, has held that the limitation with respect to investments as imposed by Section 173 of The Indiana Financial Institutions Act, applied to the total holdings of securities issued by each university. Those interested in the sale of such securities feel that this interpretation of the Act is in error and that banking institutions should be permitted to invest to the legal limit either in each issue or in each class of securities."
Under this interpretation bonds would be classified as general obligations, bonds liquidated from operations, and those liquidated from fees."

The investment limitation imposed upon banks is found in Section 173 of Chapter 40, page 176 of the Acts of 1933, as amended by Section 26, Chapter 5, page 7 of the Acts of 1935 (18-1104, Burns' 1933 R. S.):

"Except as hereinafter otherwise provided, the business of dealing in investment securities by any bank or trust company shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no event, for its own account, and no bank or trust company shall underwrite or guarantee all or any part of any issue of securities. Any bank or trust company may purchase, for its own account, and sell, investment securities, under such limitations and restrictions as the department may, by regulation, prescribe, but in no event, shall the total amount of the investment securities of any one obligor or maker, purchased or held by any bank or trust company for its own account, exceed at any time ten (10) per cent of the amount of the sound capital of such bank or trust company. As used in this section, the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, firm or corporation in the form of bonds, notes and/or debentures commonly known as 'Investment Securities,' and such further definition of the term 'investment securities' as may by regulation be prescribed by the department, but the limitations imposed by this section shall not apply to the direct or indirect obligations of the United States or the direct obligations of any territory or insular possession thereof or of the state of Indiana or any municipal corporation or taxing district thereof. Except as in this act otherwise provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by any bank or trust company of any share of stock of any corporation, unless such purchase shall be necessary to prevent loss under a
debt previously contracted in good faith; and stock so purchased or acquired shall, within six (6) months from the time of its purchase, be sold or disposed of at public or private sale, unless otherwise ordered by the department.”

There is no further definition of the term in the regulations of the Department of Financial Institutions (see Reg. 9 DF1) and the boards of Indiana University would not come within the statutory exemptions.

It may be well to say at the outset that a bond of a corporation is as much an obligation of the corporation as a loan evidenced by other paper, so that Section 173 supra is actually in the nature of a loan limitation statute as applied to investment securities. Indiana has also a general limitation on loans, which is Section 195 of Chapter 40, page 176 of the Acts of 1933, as amended by Section 32, Chapter 5, page 7, Acts 1935 (18-1301, Burns’ 1933 R. S.) which reads as follows:

“Except as otherwise provided in sections 197, 198, and 199 of this act, the total obligations of any person, firm or corporation to any bank or trust company shall, at no time, exceed ten (10) per cent of the amount of the sound capital of such bank or trust company.”

Obligations are defined in Section 196, Chapter 40, page 176 of the Acts of 1933 (18-1302, Burns’ 1933 R. S.) as follows:

“The term ‘obligations’ as used in section 195 of this act shall be construed to mean the direct liability of the maker or acceptor of paper discounted with or sold to such bank or trust company, and the liability of the indorser, drawer or guarantor who obtains a loan from, or discounts paper with, or sells paper under his guaranty to such bank or trust company, and, in the case of obligations of a copartnership or association, shall include the obligations of the several members thereof, and shall include, in the case of obligations of a corporation, all obligations of all subsidiaries thereof in which such corporation owns or controls a majority interest.”
In Anderson v. Akers (1934), 7 Fed. Supp. 924, the court said at page 942:

"* * * The purchase of the bond of a private corporation is as much a loan to that corporation as is the advance of money to such corporation on its ordinary promissory note. * * *"


Although the case specifically mentions private corporations, I see no distinction between a private corporation and a quasi public corporation such as Indiana University so far as this principle is concerned. It is probable that the words "private corporation" are used in the federal opinion because the National Bank Act specifically applied the loan limitation to obligations of individuals, partnerships and private corporations.

The provisions of Indiana law under which the proposed bonds of Indiana and Purdue Universities will be issued are found in Sections 1, 2 and 3 of Chapter 49, page 105 of the Acts of 1929 (28-5716 et seq, Burns' 1933 R. S.) and Sections 1, 2 and 3 of Chapter 137, page 425 of the Acts of 1927 (28-5722 et seq, Burns' 1933 R. S.). The first mentioned act applies to athletic field houses, gymnasiums, student unions and halls of music. The second applies to dormitories. In substance the two acts are the same. Both provide that the Trustees of Indiana University and the Trustees of Purdue University and the Trustees of State Normal Schools may erect such buildings and for the purpose of raising funds for the acquisition of property and completion of the buildings they are authorized to issue and sell bonds. Those bonds may be secured by a pledge or mortgage as follows:

1. Of the property, real or personal;
2. Of the net income;
3. Of both property and income.

For the purpose of this opinion, Section 3 of each of the aforementioned acts is important. The substance of each is the same and I quote Section 3 of the 1929 Act (28-5718, Burns' 1933 R. S.) as follows:
“No indebtedness, bond or obligation incurred or created under the authority of this act shall be or become an indebtedness of or liability against the state of Indiana nor said respective corporations, nor a lien or charge against the property or funds of said respective corporations, except to the extent of the property or income pledged or mortgaged as hereinabove authorized.”

There was outstanding as of June 30, 1945 $1,468,500 of general obligation bonds of Indiana University. In passing it should be mentioned that I find no authority for the future issuance of general obligation bonds, but it should be borne in mind that some banks will hold many of those bonds at the present time. And on December 1, 1945 there were outstanding $1,239,500 for Indiana University and $1,905,000 for Purdue, of bonds issued under the statutes set forth above and now held (at least partially) by Indiana banks.

The principal question here involved is whether the bonds to be issued under the statutes above set forth are obligations of the Board of Trustees of Indiana University and Purdue University within the meaning of the investment limitation statute, so that a bank now holding general obligation bonds up to its limit would be precluded from the purchase of new bonds, or a bank already holding bonds issued under the above statutes up to its limit would be precluded from the purchase of new bonds.

Although I find no specific case on the investment security statute the purpose of the analogous loan limitation statutes has been enunciated in many cases. Typical of these cases are the following:

Canadian Bank of Commerce v. Johnson (1929), 274 Pac. 99 (Wash.) at page 101:

"* * * The purpose of limiting the amount of loan that can be made to any one individual is for the protection of, and to promote safety of, the stockholders, depositors, and other customers of the bank, but especially the depositors and customers * * *.""

Petition of Hawesville Deposit Bank (1923), 10 S. W. (2d) 819 (Ky.) at page 820:
The purpose of the statute was to secure the depositors from the loss which might come to them from the insolvency of a single individual or corporation whose obligations were held by the bank. * * *

The statutes authorizing the issuance of bonds for dormitories, etc., specifically provide that the bonds shall not become an indebtedness or liability against the respective corporations nor a lien or charge against the property or funds of the corporation except to the extent of the property or income pledged or mortgaged. Are they, nevertheless, an obligation of the corporation within the investment limitation statute?

Somewhat analogous cases in Indiana and other states are those dealing with the question of whether an obligation or indebtedness exceeds the constitutional debt limitation of a city or is a debt against the state in violation of the Constitution.

In Kasch v. Miller (1922), 135 N. E. 813 (Ohio), bonds were issued by the State of Ohio to construct reservoirs, dams, etc., in connection with a flood control and water resource program. The lien was expressly limited to the improvements and the receipts from the improvements were pledged to pay bonds. The statute further provided that the state should not tax to pay the bonds or otherwise respond to payment. It was there held that this was not a state debt.

In Fox v. City of Bicknell (1923), 193 Ind. 537, the court held that if an obligation was payable solely out of revenues, it was not a debt of the city. This case was followed by Underwood v. Fairbanks Morse & Co. (1933), 205 Ind. 316, and Edwards v. Housing Authority of City of Muncie (1939), 215 Ind. 330. It must be conceded that the approach in those cases is inverse to that here involved. In other words, the question before the court in those cases seem to be whether the state or the city will eventually have to pay. If so, it is a debt of the state or of the city. Based upon that inquiry, a distinction is made between the cases where the obligation is payable solely out of revenues and the case where the city is merely freed of direct responsibility but will eventually have to pay out of its general resources in order to prevent foreclosure.
For instance, in Eddy Valve Company v. Town of Crown Point (1906), 166 Ind. 613, the town took over the water plant on which there was a mortgage but expressly provided that the town should not be liable. However, no provision was made for payment out of revenues of the water plant and the court said it was a debt of the city because sooner or later the city would have to pay to prevent loss of the water plant.

The approach in this case is whether an obligation is created which will place the bank in a position where the default of one person, partnership, or corporation will jeopardize the solvency of the bank. But it seems to me that the same distinction between the cases where revenues are pledged, and where they are not, is valid for this purpose.

If in issuing obligations, the university merely mortgages the real and personal property without a pledge of the income, it means that the university, out of its general revenues will have to meet the bond obligations or the bank must resort to the security, but if revenues are pledged a specific fund is provided for the payment of the indebtedness, and the bank does not have to take the risk that the general revenues of the university will be sufficient to meet the obligation.

My opinion is that a state banking institution may legally invest up to and including ten per cent of its sound capital in each class of the following obligations:

Class 1:
General Obligation bonds
Bonds issued under the statutes set forth secured by the property constructed but where net income is not pledged.

Class 2:
Bonds issued under the statutes set forth herein, secured by mortgage upon the property to be constructed and a pledge of new income, each issue being considered a separate class.

The investment limitation applies to all of Class 1 added together. The investment limitation applies separately to each issue of Class 2. A bank may hold its limit of Class 1 plus its limit in each issue of Class 2.