FINANCIAL INSTITUTIONS, DEPARTMENT OF: Banks and banking. Right to borrow money and pledge assets to secure same.

July 12, 1937.

Hon. R. A. McKinley, Director,
Department of Financial Institutions,
Indianapolis, Indiana.

Dear Sir:

In reply to your letter of July 3 with reference to a proposed loan to the Michigan City Trust and Savings Bank by the Federal Deposit Insurance Corporation of Washington, D. C., in which they propose to borrow $305,000.00, the same to be secured by collateral of the assets of the bank, you submit and there will be answered in the order submitted the following questions:

> "1. The right of the bank to borrow money in the sum contemplated and on the terms contemplated.
>
> "2. The right of the bank to pledge assets of the nature and to the extent contemplated.
>
> "3. The right of the bank to transfer its acceptable assets and business to another institution in consideration of the assumption of liabilities of an equivalent amount.
>
> "4. The statutory limitations imposed on foreclosure or liquidation of collateral pledged by the bank under these circumstances.
>
> "5. The procedure to be followed in order that the bank may be duly authorized to borrow, to pledge assets, and to transfer its acceptable assets and business to another bank, including the requirements with respect to stockholders' vote or consent, and approval by supervising state authorities.
>
> "6. Citations to applicable statutes, court opinions, regulations or interpreted opinions of state officials covering these questions."

In answer to your first question, beg to say that our statute governing financial institutions, the same being section 17, chapter 33, Acts of the Indiana General Assembly, 1937, provides that any bank or trust company shall have power

> "to borrow money and to issue its notes, bonds or debentures to evidence any such borrowing and to mortgage, pledge or hypothecate any of its assets to secure the repayment thereof; * * *"

This would seem to answer questions one and two in the affirmative and as additional authority for such statement your attention is directed to the case of Shornick, Receiver v. Butler, 205 Ind. 304. Our Supreme Court has held that:

> "The right of a bank to borrow money and pledge its assets for the payment thereof is beyond serious question."

Further,

> "We find no constitutional or statutory enactments, no practices of officials or judicial decisions in this state indicating that the pledging of collateral to secure deposits is against public policy."

As to the third question presented our statute provides in article 5 of the Financial Institutions Act, for the sale of the entire assets of a bank upon such terms and conditions and for such consideration as it deems expedient by complying with the provisions of such article.

It is my opinion, therefore, that under our law a bank has a right to sell its entire assets to another institution in consideration for the assumption of its liabilities, subject to the terms and conditions of the statute.

Question four asks for statutory limitations imposed on liquidation or pledged collateral.

There are no statutory limitations generally on pledged collateral and our Appellate Court has held that one who holds property as pledgee to secure the payment of indebtedness holds the pledged property as trustee for the pledgor and his right to sell the property is limited by the contract, being guided at all times by the utmost good faith.

Eppert v. Lowish, 91 App. 231.

Question five calls for the procedure to be followed in order that the bank may be duly authorized to borrow, to pledge assets, etc. There are no statutory requirements as to the procedure to be followed for the borrowing of money. The

general rules which apply to the conduct of the business by the board of directors should be followed, such as the adoption of resolutions and instructions to the officers with reference to the transaction of such business. Of course, a complete record should be kept in the minutes of these transactions.

Sections 137, 138, 139, 140 and 141 of the Financial Institutions Act, the same being chapter 40 of the Acts of the Indiana General Assembly, 1933, govern the provisions with reference to the sale of the entire assets of the bank.

As to citations of authority the rule seems to be that contracts whereby one bank takes over the assets and assumes the liabilities of a failing bank have been generally approved. As was said in the case of City National Bank v. Fuller, 52 Fed. (2d) 870,

> "It has become something of a custom of national banks to take over other banks in failing circumstances, and this has received the approval of the Comptroller of the Currency. If the transaction is a fair one, it is in the public interest. This court in Schofield v. State National Bank of Denver, Colorado, 97 F. 282, held the taking over of the assets and the assumption of liabilities of another bank was within the power granted to directors of national banks by section 24 (7), title 12, U. S. C. A., *supra*. In construing a transaction between two national banks in First National Bank v. Harris, 27 F. (2d) 117, 124, this court said: 'It was an out and out sale of assets in consideration of an assumption of liability with an accounting over for any surplus realized.' "

The annotation in 84 A. L. R. at page 1427 holds and cites numerous authorities in support of the following proposition:

> "Agreements by which one or more existing banks, or a bank newly organized for the purpose, undertake to assist an insolvent or failing bank, generally by taking over its assets and assuming its liabilities, have been held not to be ultra vires, contrary to public policy, or otherwise illegal, but to constitute valid contracts."

The above authorities, together with those cited in this opinion are submitted for your consideration.