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THE PHILIPPINE BANKING LAWS [1]

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Banks Defined.—A bank is "an association or corporation whose business it is to receive money on deposit, cash checks or drafts, discount commercial papers, make loans, and issue promisory notes payable to bearer, called 'bank-notes'" (Wells v. Norton Pacific Ry. Co., 23 Fed. 469, 471). For the purpose of our internal revenue law, a bank "includes every incorporated or other bank, and every person, association or company having a place of business where credits are open by the deposit or collection of money or currency subject to be paid or remitted upon draft, check, or order, or whose money is advanced or loaned on stocks, bonds, bullion, bills of exchange, or promissory notes are received for discount or for sale" (Sec. 1449, Ad. C.). A "banker" is an unincorporated association exercising banking powers, as distinguished from a bank which denotes an incorporated institution.

Kinds of Banks.—Banks may be classified as either domestic or foreign. Domestic banks may be organized either under special charters, as the Philippine National Bank and the Bank of the Philippine Islands, or under the general incorporation law (Acts Nos. 2938, 1790 and 3330). The latter kind may be further subdivided into savings and mortgage banks and commercial banks.

Savings and mortgage banks or those organized primarily for the purpose of accumulating the small savings of depositors and investing them, together with their capitals, in bonds or in loans secured by bonds, bullion or real-estate mortgages or in any combination of the aforementioned forms of investment (Sec. 103, Corporation Law); while commercial banks are those which "receive the money of others on deposit and use it, together with their own capitals, to form a joint fund which they

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make a business of employing either directly or indirectly in the making of loans, the maintenance of a note circulation, or in the purchase, sale or collection of bills of exchange or other kinds of negotiable papers" (Sec. 116 Corporation Law). Commercial banks may, in addition, carry on the business of a trust corporation if their paid-in capitals range from two hundred thousand pesos to five hundred thousand pesos, depending on the number of inhabitants of the place where located, but subject as regards their trust business to the same provisions of law as govern the trust business of a trust corporation (Sec. 133, Corporation Law). The Philippine National Bank and to the Bank of the Philippine Islands were also authorized to engage in trust business under the same conditions (Id.). On the other hand, a trust corporation may, with the approval of the Bank Commissioner, carry a commercial banking business but such business must be kept separate and distinct from its trust business (Id.).

A foreign banking corporation, like any other business corporation, may transact business in the Philippines only after obtaining a license for that purpose from the Secretary of Finance. The Secretary of Finance may issue the license upon recommendation of the Bank Commissioner, whose duty it is to "verify the information contained in the statement of the managing agent or representative of such banking corporation, as well as to make any other or further investigation as to the persons, conditions and circumstances surrounding or in any manner affecting such banking corporation" and to recommend the issuance of the license if he is satisfied that such a step will promote the public interest and convenience" (Sec. 68, Corporation Law).

Powers of Banks.—In General.—Banking corporations shall have the general powers incident to corporations set forth in Act No. 1459, as amended, and shall likewise have such incidental powers as shall be necessary to carry on the business of banking (Sec. 2, Act No. 3154; Sec. 117, Corporation Law). The powers of banking corporations are necessarily limited to such powers expressly granted to them and those essential to the exercise of those expressly granted. So, a grant of some

banking powers to a corporation does not authorize it to exercise other banking powers not expressly granted or necessary to the exercise of those which are granted (7 C. J. p. 586).

It is said that "the principal function of banks are to receive and pay deposits, to buy and sell exchange, and to loan money. Its central function is to substitute its own credit for that of individuals, and the test of its powers in a particular enterprise is not the presence of risk, but the relation of the act to substitution of credit" (4 Michie, Banks & Banking, Per. Ed., p. 3).

No person, association or corporation shall conduct the business of a mortgage and savings bank or of a commercial bank, or advertize or hold itself out as being engaged in the business of such institution, or use in connection with its business the words "bank", "banker", or "banking", or solicit or receive deposits of money for deposit, disbursement, safe-keeping, or otherwise transact any banking business, without first having complied with the provisions of the Corporation Law in so far as it relates to banking institutions and conduct its business in accordance therewith (Sec. 190-4/7, Corporation Law). So, the provisions of the Corporation Law relating to banking corporations are also to be applied or extended to individuals and partnerships engaged in banking business in so far as practicable, but there is nothing in our law which prohibits private individuals from engaging in banking. However, the law-making body may require incorporation as a condition to doing banking business as that requirement amounts only to a regulation, and not a prohibition, and therefore a valid exercise of police power without unconstitutionally interfering with the right of an individual to transact such business (Shalleverger v. First Nat. Bank, 219 U. S. 114, 55 L. Ed. 117; Noble State Bank v. Haskell, 319 U. S. 104, 56 L. Ed. 112). Any person, association or corporation who shall transact banking business without having first complied with the provisions of the Corporation Law relating to banks shall be punished by a fine of five hundred pesos for each day during which such violation is permitted or repeated; and if committed by a corporation, the offiers and directors thereof shall be jointly and severally liable with the corporation (Sec. 190-4/7 Corporation Law).

Unauthorized banking should, however, be distinguished from an unauthorized act of an authorized bank, the first being

a violation of an expressed law and the second constituting an ultra vires act. The acts of an unauthorized bank are absolutely void, but the acts of authorized banks in excess of its authority are generally voidable only. Ultra vires acts of banks are not necessarily invalid as to private parties contracting with it for the doctrine of ultra vires has no application in favor of banking corporation for wrongs committed by them. The government may, however, forfeit or revoke the bank's charter for having exceeded its charter powers. (4 Michie, Id. pp. 63-64)

We will now proceed to a brief exposition of the important specific powers of banks.

BANK DEPOSITS.—The chief business of a bank is to receive and lend money. The money received is called deposit, a term which is not at all legally accurate as in case of general deposits the bank may use or invest the money received for its own account.

Bank deposits may be divided into two general classes:

"One in which the bank becomes the bailee of the depositor, the title to the thing deposited remaining with the latter; and the other where money is the thing deposited in accordance with a custom peculiar to the banking business, where the depositor, for his own convenience, parts with the title to the money and lends it to the bank, and the latter, in consideration of the loan of the money and the right to use it for its own profit, agrees to refund the same amount, or any part thereof, on demand. The latter is a general deposit which ordinarily consists of money that is mingled with the other money of a bank, the entire amount forming a single fund, from which depositors are paid. A deposit is general where a sum of money is left with a bank for safe-keeping, subject to order, and payable, not in the specific money deposited, but in an equal sum, whether it bears interest or not. It is a deposit of money in the usual course of banking business generally to the credit of the depositor to be drawn on in the usual course of such business. In other words, a general deposit in a bank is so much money to the depositor's credit; it is a debt to him from the bank, payable on demand to his order, not property capable of identification and specific appropriation. Where a bank collects notes and issues cashier's checks for the amount, the funds are on general deposit. A deposit is general unless there is an agreement that it shall be special or be applied to a special purpose, or it is made under circumstances creating a trust relation. And a deposit is presumed to be general, unless it otherwise appear. The fact that a fund is subject to check implies that it is a general deposit, possessed of no trust character whatever. An understanding between a bank and a depositor that he should keep a deposit in the bank sufficient to satisfy the claims of local investors is held not to prevent the deposit from being a

general deposit, subject to check; such understanding relating only to the size of the account and there being no showing that the bank considered the deposit charged with any trust in favor of local investors." (5 Michie, pp. 23-26)

General deposit may, in turn, be fixed or time deposit, current account or checking deposit, or savings deposit.

A bank, "in the absence of a special agreement imparting a different character to the transaction, becomes the absolute owner of money deposited with it to the general credit of the depositor, as soon as it is received. The legal title to the money passes to the bank, which has a right to mix it with its other funds, and invest and use it as it pleases, for its own benefit in its usual financial operations". (5 Michied, Id. pp. 29-31). Our Supreme Court, in the cases of "San Carlos Milling Co. vs. Bank of the Philippine Islands and China Banking Corporation", 59 Phil. 59, "Soriano vs. Philippine National Bank", G. R. No. 41480 (unpublished) and "Gullas vs. Philippine National Bank", 34 O. G. 172, consistently held that the relation of the depositor with the bank in case of a general deposit is one of creditor and debtor. Our Supreme Court in an early case, Rogers vs. Smith, Bell & Co., 10 Phil. 319, seemed to sustain the view that if the depositary had the right to use the money deposited the relation is one of irregular deposit, but that case was impliedly overruled in the case of "Compañia Agricola de Ultramar vs. Nepomuceno", 50 Phil. 283.

The question as to whether a general deposit creates the relation of creditor and debtor or amounts only to an irregular deposit defined in Article 1768 of the Civil Code and, therefore, constituting a preferred credit, was squarely presented before the Supreme Court in the case of "In re Liquidation of the Mercantile Bank of China", G. R. No. 43426, still pending decision.[2]

The duty of the bank with regard to money deposited is given as follows:

"The specialized function of a bank is to serve as a place of deposit for money, to keep it safely while on deposit, and to pay it out, upon demand, to the person who effected the deposit or upon his order. A bank is not a guardian of trust funds deposited with it in the sense that it must see to their proper application, nor is it its business to pry into the uses to which moneys on deposit in its vault are being put; and so long as it

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[2] Decided March 31, 1938. It was held in this case that:

"Hemos dicho en la causa R. G. No. 43682 que los llamados depositos en cuenta corriente, de ahorro y a plazo fijo, celebrados con el banco insol-

serves its function and pays the money out in good faith to the person who deposited it, or upon his order, without knowledge or notice that it is in fact assisting in the misappropriation of the fund, the bank will be protected. As is well said by the author of the monographic article on Banks and Banking in Ruling Case Law, it would seriously interfere with commercial transactions to charge banks with the duty of supervising the administration of trust funds, when, in due course of business, they receive checks and drafts in proper form drawn upon such funds in their custody. The law imposes no such duty upon them (3 R. C. L., 549; see also cases cited in 7 C. J., 644, 645, note 25)." (Fulton Iron Works Co. vs. China Banking Corporation, 55 Phil., pp. 208, 216-217)

"In brief, this is a case where 132 checks made out in the name of the Insular Drug Co., Inc., were brought to the branch office of the Philippine National Bank in Iloilo by Foerster, a salesman of the drug company, Foerster's wife, and Foerster's clerk. The bank could tell by the checks themselves that money belonged to the Insular Drug Co., Inc., and not to Foerster or his wife or his clerk. When the bank credited those checks to the personal account of Foerster and permitted Foerster and his wife to make withdrawals without there being any authority from the drug company to do so, the bank made itself responsible to the drug company for the amounts represented by the checks. The bank could relieve itself from responsibility by pleading and proving that after the money was withdrawn from the bank it passed to the drug company which thus suffered no loss, but the bank has not done so. Much more could be said about this case, but it suffices to state in conclusion that the bank will have to stand the loss occasioned by the negligence of its agents." (Insular Drug Co. vs. National Bank, 58 Phil., pp. 684, 688)

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vente, son mercantiles y deben regirse por el Cidigo de Comercio, y que la clasificación y preferencia de los creditos envueltos en esta liquidación deben determinarse con arreglo a la Ley de Insolvencia No. 1986, como está enmendada, en sus Articulos 48, 49 y 50.

"La cuenta corriente y los llamados depositos de ahorro y a plazo fijo no son depositos en los terminos en que este contrato se define por el Código de Comercio y no tiene al efecto ni la clasificación legal que se da a este contrato en los Articulos 908, y 909, párrafo 3.o, del Código de Comercio y 48, párrafo 3.o, de la Ley de Insolvencia.

"Hay deposito cuando se entrega al depositario la cosa que constituye su objeto, con obligación de conservarla, según la reciba (Articulos 305 y 306 del Código de Comercio). Es, por consiguiente, esencial en un deposito mercantil que se conserve la cosa que se recibió, lo cual excluye su uso por el depositario. De tal manera es esencial esta condición en el deposito que pierde su caracter, ocnvirtiendose en otro contrato si, con asentimiento del depositante, el depositorio dispusiera de las cosas que fueron objeto del deposito (Articulo 309 del Código de Comercio). En el contrato de cuenta corriente el banco puede disponer para sus operaciones del dinero que recib e en este concepto, con la sóla obligación de atender al pago de los cheques que vaya expidiendo el contra-correntista.

As to special deposit or deposit of money, bonds, bullion and other valuables for safe-keeping, the same is governed by the provisions of Title IV, Book II, the Commercial Code, referring to deposits, in relation with Title XI, Book IV, of the Civil Code.

Under our law savings and mortgage banks and commercial banking corporations are expressly authorized to receive deposites and invest them in the manner prescribed by the statutes (Secs. 16, 103 and 116, Corporation Law), but are required to see to it that the deposits do not amount to more than ten times their unimpaired capital and surpluses and to make the proper adjustment of their capital stock accounts at the end of each

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Esto se infiera de la provision legal que obliga al banco a tener en su oder en todo tiempo una cantidad igual al 18% de la cantidad total que hubiere recibido en cuenta corriente, provision que no tendria objeto si, de todos modos, el banco estuviera obligado a conservar la misma cantidad recibida y no pudiera usuarla en sus operaciones. Es, por tanto, claro que el contrato de cuenta corriente lleva consigo un aspecto que le hace esencialmente incompatible con el deposito.

"Además, los Articulos 908 y 909 del Código de Comercio y el Arti- en poder del insolvente, deben, sin embargo, considerarse de dominio ajeno por no habersele transferido la propiedad de los mismos, incluye los bienes recibidos en cuenta corriente, lo cual significa que se considera que éstos no son de propiedad ajena, sino del insolvente quién, por tanto, puede usarlos en sus operaciones, El mero hecho de considerarse los bienes en deposito como de pertenencia ajena y no los recibidos en cuenta corriente (Articulos 308 y 909, párrafos 3 y 6, del Código de Commercio) equvale a una declaración de que la cuenta corriente no es deposito.

"La misma circunstancia de que la ley, al excluir de los bienes considerados de ajena pertenencia los caudales recibidos en cuenta corriente, los excluye de los caudales meramente remitidos al insolvente (Articulo 48, párrafo 6, de la Ley de Insolvencia) y no de los bienes recibidos en deposito (Articulo 48, parrafo 3, de la misma ley), es prueba de que no considera la cuenta corriente como deposito en ningún concepto.

"De todos modos, los caudales remitidos en cuenta corriente no constituyen, con arreglo al Articulo 48, parrafo 6, de la Ley de Insolvencia, bienes de dominio ajeno que deben ser puestos a disposición de sus legitimos dueños. Por otra parte, tampoco constituyen credito preferente, según el Articulo 50. Deben, por tanto, ser considerados créditos ordinarios al tenor del Articulo 49 de la imsma ley.

"Lo dicho hasta aqui es aplicable con mayor razón a los llamados depositos de ahorro y a plazo fijo.

"Por estas consideraciones y por las que hemos expuesto en la causa R G. No. 43682, revocando en este respecto la sentencia apelada, declaramos que las reclamaciones en virtud de cuenta corriente y de los llamados depositos de ahorro y a plazo fijo no son preferentes."

year in order to maintain the required ratio (Secs. 103 and 118, Corporation Law). A deposit, in order to be binding upon the bank, must have been received by its agent or officer authorized to receive deposits, but any agent or officer of the bank who receives deposits within the bank during banking hours binds the bank, unless the depositors have notice of lack of power (Magie, Banks and Banking, 3rd Ed. p. 272). The payment of a deposit to any one serving behind the counter of a bank is valid, and if he retains the money for his own use, the bank is liable (Id. p. 273), but the rule is otherwise if the customer entrusts money to be deposited to an agent or employee of the bank, who was not authorized to receive it, such person is the agent of the customer and the latter is the one answerable for any deficit resulting from the fraud of such agent (Id. p. 43). The relationship between the bank and the depositor shall be determined, as in all other contracts, by the agreement of the parties and their intention (5 Michie, Id., p. 21).

Savings and mortgage banks shall fix by regulations, a brief and clear resume of which shall be printed in the pass books, the manner by which the depositors or their legal representatives may petition for the return of their savings deposits. They may also provide in their by-laws that depositors shall give notice of not more than 90 before their deposits may be paid, and if so provided it can not be waived even by express agreement with the depositors (Sec. 111, Corporation Law). Whenever the funds disposable for the payment of calls for repayment of savings deposits are insufficient, no new loans or investments of the funds of depositors or earnings of such funds shall be made until the call of the depositors has been satisfied, and violation by any officer or director of the bank shall be punished by imprisonment and fine (Sec. 112, Id.). Savings and mortgage banks shall not pay any savings deposit or interest thereon, or any portion of the savings deposit or any check or draft or note drawn upon it by savings depositors, unless the pass book is produced and proper entry made therein and such banks may also make regulations governing payments to depositors in case of the loss of pass books or in other cases where production of the pass books becomes impossible, but such regulations shall be subject to the approval of the Bank Commissioner who may issue a uniform regulations for all savings and mortgage banks (Sec. 111, Id.). Commercial banking corporations may

also accept savings deposits if they have complied with the minimum capital stock requirements of savings and mortgage banks located in the same place (Sec. 118, Id.).

No banking corporation, either commercial or savings and mortgage bank, unless with the approval of the Bank Commissioner, may carry on deposit with another person, firm, corporation, or entity, an amount in excess of 25% of its unimpaired capital and surplus, after deducting sums due by it to the depositor (Secs. 106 and 118, Corporation Law). No deposit shall be accepted after the bank has become insolvent, otherwise the director or officer who receives the deposit with knowledge of such fact shall be criminally liable (Secs. 115 and 129, Id.) and the amount thus deposited may be reclaimed by the depositor.

Savings and mortgage banks and commercial banks accepting savings deposits shall keep on hand or in deposit with the Treasurer a reserve equal to at least 5% of their total savings deposit in lawful money of the Philippines or of the United States, or in Philippine or United States Government bonds (Secs. 111 and 125, Corporation Law). Aside from this, each commercial bank shall at all times have on hand in lawful money of the Philippines or of the United States an amount equal to at least 18% of the aggregate amount of its deposits in current accounts which are payable on demand and of its fixed deposits coming due within 30 days (Sec. 125, In.). If a commercial bank is designated a government depository and has given the required security (Sec. 625, Administrative Code), it shall be relieved from keeping the 18% and 5% reserves on the amount of the Government deposits (Sec. 125, Corporation Law). The Bank Commissioner may compel savings and mortgage banks and commercial booking corporations to keep the legal reserve to proper level; and in case the reserves required of commercial banks shall be below the amount required, they shall not make any new loans or discount or declare dividend until the reserves have been restored (Secs. 111 and 126, Corporation Law). Reserve deficiencies, whether by savings and mortgage banks or by commercial banks, shall be penalized at the rate of 1% per month upon the amount of the deficiency and for the period of its duration, to be collected by the Collector of Internal Revenue, but a continous deficiency for a period of 30 days by commercial banks shall constitute a ground for the wound-

ing up of its business by the Bank Commissioner (Id.) Regulation 4, Series of 1930 of the Office of the Bank Commissioner prescribes the manner by which calculation of reserves against deposits shall be made.

BANK LOANS AND DISCOUNTS.—Banking corporations, both savings and mortgage banks and commercial banks, are expressly authorized by law to make loans as a means of investing their funds and money received as deposits. However, the power of savings and mortgage banks to make loans is subject to the limitation that the loan shall in no case "be for a longer period than five years, unless such loan is made payable in monthly, quarterly, semiannual or annual installments, in which case it may have a maturity of ten years" (Sec. 104, Corporation Law), and to the further condition that no loan on the security of real estate shall be made unless the title to such real estate shall have been first registered under the Land Registration Act or the Cadastral Act, shall be in the name of the mortgagor and free from all encumbrances, and unless the mortgage shall be a preferred claim on the property therein described as against the whole world (Secs. 106 and 114, Id.). The manner, conditions and limitations under which savings and mortgage banks shall make loans to be secured by real estate mortgages or pledge of gold or silver bullion, bonds or other evidences of debt, draft, bills of exchange, acceptances or notes are prescribed in Section 105 of the Corporation Law.[3]

The direct indebtedness to a savings and mortgage bank of any person, firm, corporation, or entity shall be limited to 25% of its unimpaired capital and surplus, but to this amount shall not be included loans secured by pledge of gold and silver bullion, or loans secured by bonds or evidences of debt of the Government of the Philippines or of the United States, or drafts, bills of exchange, acceptances or notes guaranteed by solvent banks operating in the Philippines (Sec. 106, Id.).

Commercial banks may grant loans under the following conditions:

(1) The loans shall be made against personal security or against securities consisting of personal property or first mortgages on improved real estate and insured improvements thereon (Sec. 117, Id.).

[3] Under Commonwealth Act No. 306 amending Section 105 of the Corporation Law, approved June 9, 1938, savings and mortgage banks may grant loans on the security of their own deposits.

(2) Loans made against real estates shall mature in five years at most and for amounts not to exceed 60% of the appraised value of the real estates and of the insured improvements, and shall not in the aggregate exceed 25% of the unimpaired capital stock and surplus one-half of the total savings deposits, at the option of the bank (Sec. 117, Id.).

(3) The total liabilities of any person, company, corporation, or firm for money borrowed, including the liabilities of the several members thereof, shall at no time exceed 15% of the unimpaired capital stock and surplus of the bank; but the discount of bills of exchange drawn in good faith against actually existing values and the discount of commercial business paper actually owned by the person negotiating the same shall not be considered as money borrowed. But this amount may be increased by another 15% provided that the additional liabilities are secured by shipping documents, warehouse receipts or other similar documents transferring or securing title covering readily marketable, nonperishable staples, when fully covered by insurance and have a market value of 125% of such additional liabilities (Sec. 119, Id.). This prohibition was borrowed from Section 5200 of the United States Revised Statutes and is intended to guide "banks from the hazard of loaning money in improvident amounts upon speculative and accommodation paper, but it contemplated and permitted to an unlimited amount, the discount of paper used and required in facilitating the transfer of property and money in the transaction of legitimate business of the country" (Second National Bank vs. Burt, 93 N. Y. 344). In this limitation shall be included the amount extended by a commercial bank against trust receipts (Regulation No. 3, Series of 1930).

(4) The aggregate market value of stock of other corporations held as collateral shall not exceed 15% of the unimpaired capital stock and surplus of the bank (Sec. 119, Id.).

(5) Loans shall not be granted on the security of its own stock unless necessary to prevent loss upon a debt previously contracted in good faith (Sec. 120 Id.). This incorporates the provision of Section 5201 of the United States Revised Statutes. The purpose this limitation is to prohibit the bank from acquiring a lien on its own stock against its stockholders (Bullard v. Nat. Bank, 193 U. S. 581).

Savings and mortgage banks are prohibited absolutely from granting loans to its directors and officers, either directly or indirectly (Sec. 113, Id.), while commercial banks may grant loans to them with the approval in writing entered upon the records of the bank by a majority of the directors, excluding the borrowing director (Sec. 133, Id.). Loans cannot be made to the Bank Commissioner and all employees of the Bureau of Banking without the written approval of the Secretary of Finance (Sec. 1635, Administrative Code).

"A discount by a bank means *ex vi termini* a deduction, or draw back, made upon its advances or loans of money upon negotiable paper, or evidence of debt, payable at a future day, which are transferred to the bank" (Bouvier Dictionary). In another word, "a discount is a transaction by which a bank, on making a loan on a promissory note or other paper, deducts the interest in advance, so that the borrower receives only the face value of the obligation less the interest on such face value from the time when the loan is negotiated, until its maturity (7 C. J., 712). The term "discount" applies to both the transaction and the deduction. Discounting is considered incidental to the banking business and banks may engage in this transaction without express authority. The power to discount is vested exclusively to the board of directors of the bank, although the performance of the act may be delegated to an officer or agent of the bank (Magie, Banks and Banking, p. 425).

Both savings and mortgage banks and commercial banks are expressly authorized by our law to discount drafts, bills of exchange, acceptances and notes; but the authority of the former class of banks is limited to cases where such commercial papers arise out of current commercial transaction guaranteed by solvent bank operating in the Philippines and that their aggregate investment along this line shall not exceed 10% of their total assets, while no such limitation is imposed upon commercial banks (Secs. 105 and 117, Corporation Law). Discounts are not to be considered as loans if made on bills of exchange drawn in good faith against actually existing values or on commercial papers actually owned by person negotiating them (Sec. 119, Id.).

Discount is not to be confused with outright purchase. "If the party dealing with the bank assumes a responsibility, it is a loan; if he does not, it is an advance made to him in conside-

ration of the transfer without recourse or by delivery" (First Nat. Bank of Greenville vs. Sherburne, 14 Ill. App. 566). So purchases of commercial papers take place only when the same are negotiated to the banks either by delivery or by qualified indorsement. The discussion of the distinction between discounting and purchase is of little importance for our purpose since all banks, under our statutes, may not only discount, but also purchase, negotiable instruments, although savings and mortgage banks can only deal with those papers guaranteed by solvent banks doing business in the Philippines (Secs. 105 and 116, Corporation Law).

BANK COLLECTIONS.—Although our statutes are silent as to the authority of banks to undertake collections of commercial papers, such authority shall be deemed as an incident to the business of banking (7 C. J. 597). The contract and the extent of the authority of a collecting bank to collect the proceeds of a negotiable instrument are contained and defined in the instruction given by the owner or by the forwarding bank and in the indorsement on the instrument. By the weight of authority, the relation between the owner of the commercial paper and the collecting bank is one of agency, the owner being the principal and the collecting bank the agent (7 C. J. 597; Magie, Banks and Banking p. 491); but after collection has been made the relation becomes that of bailor and bailee, unless the collecting bank is authorized to hold the amount collected as a general deposit in which case the relation is that of creditor and debtor.

The title to the instrument remains in the owner if it is indorsed restrictively such as "for collection", "for collection and remittance", "for deposit to the credit of" or "for deposit to the account of"; but if indorsed in blank or specially, the title to the instrument passes to the collecting bank. It becomes important to determine who has the title to the instrument in case a third person seeks to attach the instrument or the proceeds collected.

The relation between the owner of the instrument and the collecting bank gives rise to varied situations and multifarious legal consequences, such as the rights, duties and powers of the collecting bank, its liability, care and diligence to be observed, authority to appoint a sub-agent for collection and its liability for the act of the subagent, effect of the insolvency of the collecting bank or of the remitting bank and so forth which we

can not for the moment enter into details. Suffice it to say that since the contract of agency is deemed to have been perfected upon the collecting bank accepting the undertaking, the laws of the country where collection is to be made therefore applies. The relation, power and duties of the collecting bank, if collection is to be made in the Philippines, shall be governed by the provisions of our Commercial Code on agency, supplemented by those in the Civil Code, and in absence thereof then by the general principles of banking.

OTHER POWERS.—Any savings and mortgage bank may, with the approval of the Bank Commissioner, borrow money provided that the aggregate liability does not exceed 50% of its paid-up and unimpaired capital stock, but any commercial bank may incur indebtedness to the full extent of its paid-up and unimpaired capital, excepting those on account of demands for money deposited with or collected by it, bills of exchange or drafts drawn against money actually on deposit to the bank or due thereto, and liabilities to the stockholders for dividends and reserve profits (Secs. 107 and 121, Corporation Law).

No bank, however, shall enter directly or indirectly into any contract of guaranty or suretyship to guarantee the interest or principal of the obligation of any person or entity, but this prohibition does not apply to the borrowing of money thru rediscounting of its receivables or otherwise, to the granting or guaranteeing of acceptance credits in the ordinary course of business, to certification of checks, to the release of documents attached to items received for collection, and to any transaction generally regarded as within the common usage and practices of banks (Sec. 190-2/7, Id.).

Banks shall have power to purchase, hold and convey real property necessary for the transaction of its business or for their immediate accommodation, but they shall not hold real property purchased to secure any debt due to if for a period longer than five years (Secs. 108 and 122, Corporation Law). This limitation shall not be strictly construed unless "its conduct is characterized by obduracy or pertinacity in contempt of the law" (Govt. vs. El Hogar Filipino, 50 Phil. 399, 408).

Commercial banks having paid-up capital of over one million pesos may establish branches in the Philippines, with prior approval of the Bank Commissioner, for the business of which the principal institution shall be responsible, the same to be

treated as an entirety (Secs. 128 and 190-3/7, Corporation Law); or in foreign countries, with the prior approval of the Secretary of Finance upon the recommendation of the Bank Commissioner, but subject to inspection at any time by the latter official (Act No. 3522). Commercial banks may also maintain note circulation (Sec. 116, Corporation Law) subject to the payment of taxes imposed by Sections 1499 *et. seq.* of the Revised Administrative Code.

LIENS OF BANKS.—In the United States it is a well-established principle that a bank has a general lien on all of the moneys and funds in its possession which may be used or applied to cancel any mature debt owing by the owner thereof to the bank. This general lien of banks is either the creation of the common law, specifically the law merchant, or of statutory enactment as in California and many other States. It is obvious that that principle is not applicable in this jurisdiction.

However, we have some legal provisions which may be resorted to by banks and which operate to a certain extent, and has the same effect, as the common law banker's lien. Compensation as defined in Article 1195 of our Civil Code, although legally speaking is not a lien, produces a similar effect. As we have heretofore said, a general deposit creates the relation of creditor and debtor between the depositor and the bank. Thus, the bank may compensate its money claim against the general deposit account of a customer provided that they are both creditors and debtors in their own right, that both debts are due, liquidated and demandable, and that neither is subject to lien or suit by a third person (Art. 1195, Civil Code). "When the depositor and the depository bank became reciprocally creditors and debtors of each other, their reciprocal obligations as a general rule compensate each other if both are due, liquidated and demandable" (Soriano vs. Philippine National Bank, G. R. No. 41480). In the most recent case on the subject, our Supreme Court held:

"As a general rule, a bank has a right of set-off of the deposits in its hands for the payment of any indebtedness to it on the part of a depositor. In Louisiana, however, a civil law jurisdiction, the rule is denied, and it is held that a bank has no right, without an order from or special assent of the depositor to retain out of his deposit an amount sufficient to meet his indebtedness. The basis of Lousiana doctrine is the theory of confidential contract arising from irregular deposits, e. g., the deposit of money with a banker. With freedom of selection and after

full consideration, we have decided to adopt the general rule in preference to the minority rule as more in harmony with modern banking praltice". (Gullas vs. Philippine National Bank, 34 O. G., 122, 173.)

Such compensation extinguishes both debts to the concurrent amount (Art. 1202 Civil Code). However, if the funds in the possession of the bank is given as special deposit under a contract known as *depositum* under the Civil Law or bailment under the Common law (See Art. 1758, Civil Code), instead of an ordinary loan, compensation shall take place (Arts. 1200 and 1748, Civil Code). The same is true if the customer is acting as trustee for a third person for then he is not a creditor in his own right or that the funds in the hands of the bank belonging to a person against whom it has a claim is held by the latter in the nature of a trust.

Similarly, under Article 1866 of the Civil Code "if while the pledge is in the possession of the creditor, the debtor should become indebted to him in another amount, demandable before the first debt has been paid, the creditor may continue to hold the pledge until both credits are paid him, even should it not have been stipulated that the pledge should be security for the second debt." This implied extension of the pledge operates like a banker's lien on the collateral given by a borrower to the bank. This is not, however, the case with real estate mortgages, and some of our local banks are using the so-called blanket mortgages to produce a similar effect.

Has a bank a lien on its own stock? An authority on the subject supports the view that the provisions of our Corporation Law to the effect that a corporation may sell a shareholder's stock "for the payment of any indebtedness of the stockholders to the corporation" (Sec. 13, Corporation Law) "and that no shares of stock against which the corporation holds an unpaid claim shall be transferrable on the books of the corporation" (Sec. 35, Corporation Law) impliedly create a lien in favor of the Corporation on its own stock (Fisher, The Philippine Law of Stock Corporation pp. 121-127). But Section 120 of the Corporation Law, applicable to commercial banks, prohibits the making of any loan or discount on the security of its own capital stock, which provision was interpreted by our Supreme Court to the effect that commercial banks "can have no lien on its own stock for the indebtedness of the stockholder" (Pua Cun vs. Summers, 44 Phil. 765). Since the provision of Section 120 of the Corporation Law does not embrace savings

and mortgage banks, the latter have lien on the shares of their capital stock like any other stock corporation.

DISSOLUTION AND LIQUIDATION.—Banking corporations, like other stock corporations, may be dissolved by:

"* * * (1) the expiration of the period for which it was lawfully formed; (2) by legislative enactment; (3) by judicial decree of forfeiture; (4) by voluntary surrender of its right to corporate existence; and (5) by failure to organize formally and commence the transaction of its business within two years from the date of its incorporation." (Fisher, The Philippine Law of Stock Corporation, p. 373.)

A savings and mortgage bank is authorized to provide in its by-laws rules concerning the final disposal of its surplus upon dissolution, after the payment of all liabilities (Sec. 110, Corporation Law).

It should be noted that the provisions of our Insolvency Law, Act No. 1956, are not applicable to corporations principally engaged in the banking business (Sec. 52, Insolvency Law). Section 1639 *et. seq.* of the Administrative Code prescribe the procedure and manner of distribution of the assets of an insolvent bank. If a bank is insolvent or in such a condition that its continuance in business will involve probable loss to the depositors or patrons, the Bank Commissioner shall inform the Secretary of Finance of such facts who, with the approval of the President of the Philippines, shall forbid the institution to do business in the Philippines and direct the Bank Commissioner to take charge of its assets and proceed according to law; within ten days after the Bank Commissioner takes charge of its assets, the bank may apply to the Court of First Instance for an order requiring the Bank Commissioner to show cause why he should not be enjoined from continuing such charge of the assets; within twenty days from the time he takes charge of the assets, the Bank Commissioner shall determine whether or not it can be allowed to resume business with safety; if business cannot be resumed with safety to its creditors, then he shall file a petition, thru the Solicitor General, in the Court of First Instance praying for the assistance of the Court in the liquidation of the affairs of the insolvent bank (Sec. 1639, Administrative Code). There is no law prescribing the method or manner of liquidating the assets of the insolvent bank with the exception of the requirement that "the Bank Commissioner shall thereafter, under the supervision of the Court and with all convenient speed, reduce the assets of the banking institutions to

money" (Sec. 1639, Administrative Code). In the liquidation of the Mercantile Bank of China, Civil Case No. 40704, Court of First Instance of Manila. the position of the Bank Commissioner as liquidator was generally considered as that of a receiver and laws and rules of receivership were the ones applied.

After payment of the costs of the proceedings, reasonable expenses, and the commission and fees of the Bank Commissioner, allowed by the Court the Bank Commissioner under the decree of the Court, shall pay the debts of the institution according to their legal priorities. Observance should be made that the "unencumbered assets of every savings and mortgage bank shall constitute the security of depositors who shall have priority of right over all others to such assets" (Sec. 107, Corporation Law). It would seem also that the capital stock and assets of banks organized under Act No. 3154, "constitute the security of the depositors and depositors have the priority of right over all others to such assets" as the provision of Section 5 of said law has not been expressly or impliedly repealed or modified by subsequent legislation. As to assets of foreign banks doing business in the Philippines, the "residents and citizens of the Philippines shall have preferential rights to the assets which such banking corporation has in the Philippines or on deposit with a trustee" designated by the Bank Commissioner under the provisions of Section 1 of Act No. 3520 (Sec. 1, Act No. 3520). Special deposits "which have actually been kept separate and not intermingled with the general deposits of the bank, and which can be identified, may be reclaimed" (Magee, Banks and Banking p. 620). Such deposits do not constitute a part of the assets of the bank.

Funds in the hands of the bank as trustee, such as proceeds of drafts forwarded to it for collection and remittance, never constitute, in law, a part of the assets of the bank and, therefore, the question involved in reclaiming them is not one of preference or priority among creditors (Poweshick County v. Merchants Nat. Bank, 220 N. W. 63). Also, a recovery may be had even by a general depositor if the deposit is made after the bank becomes insolvent in fact, although not in law, and received by an agent or officer of the bank with such knowledge (Secs. 115 and 129, Corporation Law).

We have one problem to solve. According to Section 1641 of the Administrative Code, the distribution of assets of an insolvent bank shall be made according to the order of legal priority of the obligations without specifying the law applicable and Section 52 of the Involvency Law expressly provides that said act shall not apply to banking corporations. However, as the principles underlying the provisions of Sections 48 to 50 of the Insolvency Law are of general application, said legal provisions shall, nevertheless, serve as guide in determining the classification and preference of credits in the liquidation of banks and banking corporations.[4]

The Bank Commissioner may also liquidate the business of a banking institution, under order of the court, if it persists in the violation of its charter or by-laws or any law, or the orders, instructions and regulations legally issued by him or whenever such institution persists in carrying on its business in an unlawful or unsafe manner (Sec. 1640, Administrative Code). Such a liquidation may also take place if a bank wilfully refuses to file a report of its financial condition or to permit an examination of its affairs (Sec. 1638, Administrative Code).
He may also wound up the business of a commercial bank if it fails to provide the necessary reserves for deposit continuously for a period of 30 days (Sec. 126, Corporation Law). The liquidation in last three cases does not carry with it the dissolution of the defaulting corporation, but the business may be suspended.

In case of voluntary liquidation, a written notice shall be sent to the Bank Commissioner before the same is undertaken, and said official shall have the right to intervene and take such steps as may be necessary to protect the interests of the creditors (Sec. 190-5/7, Corporation Law).

CONTROL AND SUPERVISION OF BANKS.—The Secretary of Finance has the general supervision over banks, which he exercises thru the Bureau of Banking (Sec. 81, Administrative Code).

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[4] In the case of "In re Liquidation of the Merchantile Bank of China", G. R. No. 43682, the Supreme Court held that Sections 48, 49 and 50 of the Insolvency Law, as amended, are applicable in the liquidation of banks, although, personally, I believe that what the said tribunal meant was that the principles contained in those three sections of the Insolvency Law are equally applicable in the liquidation of banking corporations.

The Bank Commissioner has, under the law, general and specific powers. In the exercise of his general power, "he shall have authority to issue such orders, instructions, and regulations as he may consider necessary to carry out the provisions of the law governing banking institutions and the supervision thereof, and to forbid a banking institution to transact business which is unlawful or, in his opinion, prejudicial to the creditors of such institution, and to require any banking institution to conduct its business in a lawful and safe manner, but all regulations of a general character must first be approved by the Secretary of Finance (Sec. 1634, Administrative Code). To make this power effective, the Bank Commissioner may inform the Solicitor General of such delinquency by any bank, whose duty it shall be to address a petition to the Secretary of Finance praying that the offending institution be forbidden to continue the doing of business and the prosecution of the party responsible therefor, and the Secretary of Finance, after due investigation and with the approval of the President of the Philippines, may forthwith suspend its business in the Philippines and direct the Bank Commissioner to liquidate its assets and settle its obligations (Sec. 1638, Administrative Code); or in case of violation of laws, regulations, orders or instructions, the Bank Commissioner may seek the assistance of the court of first instance to compel the defaulting institution to discontinue the violation and if necessary, under order of the court, proceed to liquidate its business (Sec. 1640, Administrative Code).

The specific powers of the Bank Commissioner include, among others, the issuance of certificates before incorporation of banking institutions to the effect that they are duly authorized to do business in the Philippines (Secs. 9-½ and 103, Corporation Law); the issuance of certificates to the effect that the articles of incorporation, by-laws, or amendments to the by-laws are in accordance with law (Secs. 18, 20 and 22, Id.); to recommend the issuance of licenses to foreign banks to transact business in the Philippines if it will promote the public interest and convenience (Sec. 68, Id.); and to approve the establishment of branch or branches by commercial banks having paid-up capital of not less than one million pesos (Sec. 128, Corporation Law).