Republic of the Philippines
Department of Trade and Industry
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

20 August 2010

SEC-OGC Opinion No. 10-26
Re: Lending Company

KAWAYAN LENDING INVESTORS, INC.
Obispo St., Poblacion, Kawayan
Biliran Province

Attention: Ms. Virginia D. Ambe
Manager

Gentlemen:

This refers to your 04 January 2010 letter addressed to Atty. Lindeza R. Rogero-Gavino, Acting Director of the Commission's Cebu Extension Office, indorsed to and received by this Office on 30 March 2010, requesting opinion on the following queries:

1. Will the 19-lender ceiling be violated if we have not sourced funds from other people but we have added stockholders or investors?

2. Please differentiate a stockholder and an investor.

3. [W]hat does it mean that a lending institution cannot engage in mortgaging; does this contemplate the situation where the mortgage is incidental to the loan application, i.e., the borrower has to put up a collateral so his loan can be released?

With regard to your first query, you state that there are fifteen (15) incorporators of your corporation, Kawayan Lending Investors, Inc. ("KLII", for brevity), and that its stockholders now number thirty-five (35).

Your first and second queries are related and, hence, are hereunder jointly discussed.

Other than from operational income or transactional income, there are two (2) basic sources by which a corporation is able to finance its operations, namely: (1) equity investments, and (2) debt contracts. In either case, money or capital is infused into the corporation, and the person who parts with such money is, in that

sense, an investor. Although both equity investments and debt placements in a corporation can be viewed as investment schemes by which the investor expects a return, nevertheless, the motivation or impetus involved in each case is different.[1]

In an equity investment, the investor buys shares of stock of the corporation and thereby becomes, and is called, a stockholder. The return of the stockholder is intricately woven with the success or loss of the operations of the corporation, that is, the return of his investment is dependent on the retained earnings component of the stockholders' equity from which he could expect to receive dividends, as well as on what is left of the corporate assets after the corporate debts and liabilities are fully paid. Because of these risks, the stockholder is given a voice or say in management, through his guaranteed participation in the election of directors/trustees and in the ratification of certain corporate acts.[2]

In debt placement, on the other hand, the investor merely extends a loan or debt to the corporation, and puts no stake on the operations of the corporation such that the contractual obligation of the latter to pay the stipulated return, i.e. interest, remains even when the corporation is incurring losses.[3] In this instance, the investor is called a lender, to whom the corporation usually issues a promissory note ("PN") or any other evidence of indebtedness to manifest that investment.

Thus, a stockholder can be considered an investor of the corporation; however, an investor is not necessarily a stockholder, as he may instead be just a lender of the corporation.

Section 3(a) of Republic Act No. 9474, or the Lending Company Act of 2007 ("Lending Act"), and Rule 2(j) of its Implementing Rules and Regulations ("IRR"), define a "lending company" as follows:

> "Lending Company shall refer to a corporation engaged in granting loans **from its own capital funds *or from funds sourced from not more than nineteen (19) persons.*** It shall not be deemed to include banking institutions, investment houses, savings and loans associations, financing companies, pawnshops, insurance companies, cooperatives and other credit institutions already regulated by law. The term shall be synonymous with lending investors." (Emphasis supplied).

As evidenced by the word "*or*" separating the phrases "*from its own capital funds*" and "*from funds sourced from not more than nineteen (19) persons*", it is clear from the above provision that the 19-lender ceiling applies only to the borrowing transactions of the corporation and does not pertain to the sale of its

[1]Cesar L. Villanueva, Philippine Corporate Law 532-533 (2001 Edition).
[2]Ibid., p. 533.
[3]Ibid., p. 534.

shares of stock.[4] There is no provision in the law which prescribes a cap to the number of stockholders that a corporation may have, subject only to the following conditions: (a) that the total number of shares issued and outstanding of the corporation must not be in excess of the authorized capital stock[5]; (b) that when the corporation issues its shares of stock to nineteen (19) persons in the Philippines during any twelve-month period, such shares must be registered with the Commission, pursuant to Section 10.1(k), in relation to Sections 8 and 12, of the Securities Regulation Code ("SRC")[6]; and (c) that if, after several issuances of shares, the corporation becomes a public company, it must comply with the disclosure/reporting requirements under the SRC.[7]

However, when the stockholders become, at the same time, lenders of the corporation and are issued PN's, then the borrowing transactions of the corporation from these stockholders now fall within the ambit, and should be counted in the computation, of the 19-lender ceiling. In this connection, when the corporation borrows from more than nineteen (19) lenders and issues PN's to all of them, these PN's, being themselves securities[8], must likewise be registered with the Commission.

Accordingly, if you merely added stockholders, with no one of them becoming your lender, such that the total number of persons from whom you borrowed (stockholders and/or the public) does not exceed nineteen (19), then we answer your first query in the negative. Otherwise, it would be in the affirmative.

As to your third query, we answer the same in the negative. It is a settled business practice that a lender may require the borrower to secure, by mortgage or otherwise, his loan. Nowhere is it provided in the Lending Act and its IRR that this practice is prohibited. Hence, the lending company can be a mortgagee of a property put up by the borrower to secure the payment of his debt or loan. What the company cannot do is to mortgage such property, it not being the owner thereof.[9]

This opinion is based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein. It shall likewise be understood that the foregoing shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts.[10] If, upon investigation, it will be disclosed that the facts relied upon are different, this Opinion shall be rendered void.

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[4]This interpretation can likewise be inferred from the SEC Office Circular dated 14 February 2001 issued by then Chairperson Lilia R. Bautista.
[5]Section 14, Corporation Code.
[6]Republic Act No. 8799 (2000).
[7]Under the SRC and SRC Rule 3 of its IRR, a public company means any corporation with a class of equity securities listed on an Exchange or with assets in excess of Fifty Million Pesos (P50,000,000.00) and having two hundred (200) or more shareholders, at least two hundred (200) of which are holding at least one hundred (100) shares of a class of its equity securities.
[8]See Section 3, SRC.
[9]Article 2085, New Civil Code.
[10]Paragraph 7, SEC Memorandum Circular No. 15, Series of 2003.

Please be guided accordingly.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel