



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

22 September 2010

SEC-OGC Opinion No. 10-28  
Re: Loan Collateral Build-Up in a  
Lending Company; Deposit  
Substitute

**PAGASA PHILIPPINES LENDING COMPANY, INC.**

No. 2 J. Delgado Street, BF Homes, Brgy. Holy Spirit,  
Quezon City

**Attention: T.I.M. Fakruzzaman**  
**President**

**Gentlemen:**

This refers to your 15 February 2010 letter addressed to the Commission's General Counsel, as supplemented by your 25 June 2010 letter addressed to Atty. Kenneth Joy Quimio of our Corporation Finance Department ("CFD", for brevity), requesting opinion on the safekeeping and disposition of the Loan Collateral Build-Up ("LCBU") of the borrowers of your company, Pagasa Philippines Lending Company, Inc. ("PPLCI").

In your 15 February 2010 letter, you mentioned that PPLCI, which was incorporated on 7 June 2007, provides entrepreneurial poor women access to financial resources through the provision of credit and the development of a regular LCBU scheme to support their future needs and livelihood enterprises. In its two (2) years of operation, the company has now a total of 56 branches with 60,978 borrowers. Because these borrowers are poor and have no capacity to provide conventional collateral, PPLCI adopted an alternative collateral scheme, that is: **every week, each borrower deposits Fifty Pesos (P50.00) as collateral, which makes up the LCBU.** This alternative collateral can be withdrawn to pay their weekly amortization or to offset their loan balances in case of default. Presently, all of the LCBU collected is placed in a separate bank account. You, however, request that only 5% or 10-13%, instead of 100%, of the LCBU balance be placed in such separate account.

In your 25 June 2010 letter, you averred that since PPLCI started operating in December of 2007, **the LCBU bank account is earning 5% bank interest, which is being added to each borrower's corresponding share in the LCBU.** However, upon the advice of the company lawyer, your management decided to temporarily stop giving LCBU interest after October 2009. You likewise mentioned that **you intend to invest the LCBU in servicing more loans to the poor communities** and that **should this be allowed by the Commission, the company would continue providing interest on the borrowers' LCBU.** As a

matter of fact, PPLCI's 2009 Audited Financial Statements does not restrict the LCBU as a separate non-current asset account, which means that the said "collaterals" are commingled with the general fund for re-lending by the company.<sup>1</sup>

Hence, your ultimate query is whether the LCBU of the borrowers can be used for relending purposes.

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).

It is clear from the above provision that a lending company is allowed to grant loans only from (1) its own capital funds, and (2) from funds sourced from not more than nineteen (19) persons. The provision does not authorize the granting of loans from the collaterals furnished by the borrowers. This is because the said collaterals legally do not belong to the creditor, in this case, the lending company. Like the thing given by way of pledge or mortgage, or any other property given as security for an obligation, the LCBU rightfully belongs to the debtor(s), in this case, the borrowers.<sup>2</sup> As such, the lending company, as creditor, cannot appropriate or dispose of the same.<sup>3</sup> In effect, the lending company holds the LCBU in trust for the legal owner, the borrowers, and will have a cause of action against the same, only when there is default on the part of the latter.<sup>4</sup> On the other hand, when the borrower fully pays his debt, the lending company is duty bound to return his LCBU. If the LCBU is re-lent by the lending company, the recovery thereof by the said paying borrower may be delayed, prejudiced and/or defeated.

In addition, the lending company may already be acting like a quasi-bank if it relends the LCBU.

A quasi-bank refers to an entity engaged in the borrowing of funds through the issuance, endorsement or assignment with recourse or acceptance of deposit substitutes as defined in Section 95 of Republic Act No. 7653 ("the New Central Bank

<sup>1</sup>Memorandum of the Commission's Office of the General Accountant dated 6 September 2010.

<sup>2</sup>Article 2085, New Civil Code.

<sup>3</sup>Article 2088, New Civil Code.

<sup>4</sup>In the same way that the pledgee or mortgagee will have the right to foreclose, and ultimately own, the thing pledged or mortgaged, in case of default.

Act") for purposes of relending or purchasing of receivables and other obligations.<sup>5</sup> The term "deposit substitutes" is defined as an alternative form of obtaining funds from the public, other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the borrower's own account, for the purpose of relending or purchasing of receivables and other obligations. These instruments may include, but need not be limited to, bankers acceptances, promissory notes, participations, certificates of assignment and similar instruments with recourse, and repurchase agreements.<sup>6</sup>

The LCBU is akin to a deposit substitute because the same is a "*form of obtaining funds from the public, other than deposits*", with the proof of receipt thereof issued by the lending company (e.g. acknowledgment receipt, deposit slip, and the like) functioning as the "*debt instrument(s) for the borrower's own account*".

Thus, to allow the company to re-lend the LCBU would be tantamount to allowing the company to perform a quasi-banking function without the requisite license from the *Bangko Sentral ng Pilipinas*.

For the foregoing reasons, we answer your query in the negative. The lending company cannot commingle the LCBU, or any percentage thereof, with its general funds, much less, re-lend the same to the public.

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.<sup>7</sup> If, upon investigation, it will be disclosed that the facts relied upon are different, this Opinion shall be rendered void.

Please be guided accordingly.

Very truly yours,



**VERNETTE G. UMALI-PACO**  
General Counsel

<sup>5</sup>Section 4, Republic Act No. 8791, the General Banking Law of 2000.

<sup>6</sup>Section 95, New Central Bank Act.

<sup>7</sup>Paragraph 7, SEC Memorandum Circular No. 15, Series of 2003.