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Combination of Loans for Lending Limit Purposes

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The rules for combining loans will vary depending on a lender's charter. National banks and federal savings banks are subject to lending limit regulations established by the OCC, while state-chartered institutions are subject to state laws and regulations. Some states, such as California, do not provide much guidance for determining when loans should be combined. In the absence of state guidance, many lenders look to the OCC regulations for guidance.

The OCC lending limit rules provide three tests for determining whether loans must be combined: (i) the direct benefit test; (ii) the common source of repayment test; and (iii) the economic interdependence test. Each of these tests, if applied correctly, assists a lender in identifying what loans must be combined for lending limit purposes.

Whether a lender is subject to the OCC lending limit rules or the rules of another regulator, the loan combination guidance provided in the OCC regulations represent a "best practice" when lending to borrowers that are related.

Attribution Based on Direct Benefit

A loan or extension of credit to A will be attributed to B when the proceeds of the loan are to be used for the "direct benefit" of B. When a loan or extension of credit to one person is attributed to another person, each person is deemed to be a borrower of the loan for lending limit purposes. If B has outstanding loans with the lender, then the loan attributed to B must be combined with all other loans to B.

The loan to A would be attributed to B if (i) all or a portion of the loan proceeds are paid to B; (ii) loan proceeds are used to purchase an asset that is transferred to B; or (iii) loan proceeds are paid to a third party on behalf of B.

In applying the direct benefit test, a lender must determine how all loan proceeds are to be used. If the settlement statement for the loan escrow shows a payment to the borrower, the lender should inquire as to the use of the proceeds and note any transfer to an affiliate of the borrower.

Aggregation Based on Common Source of Repayment

A common enterprise exists between or among borrowers when the expected source of repayment for each

loan in question is from the same source. This common source of repayment for these loans means that the risk of repayment for each loan is centralized at the source of the repayments. If the source of the repayments is impaired, then each of the loans may be at risk. Accordingly, the common source of repayment test requires the aggregation of each loan that relies on the same source of repayment. When loans are aggregated, they are combined and considered as loans to one borrower for purposes of determining compliance with the lending limit rules.

A lender may not be required to aggregate loans under the common source of repayment test, if the borrower's other sources of income (other than the common source of income) are sufficient to repay all of the borrower obligations, including the lender's loan.

Aggregation Based on Common Control and Financial Interdependence
The common control and financial interdependence test is the second type of common enterprise requiring aggregation. Loans to separate borrowers must be aggregated when a common enterprise exists. A common enterprise is deemed to exist when borrowers are related by common control and substantial financial interdependence exists between or among the borrowers.

A person is deemed to have control of an entity when that person owns 25 percent or more of the entity. As aggregation requires both control and financial interdependence, a lender should first identify the owners of each related borrower and that owner's ownership interest.

Substantial financial interdependence is considered to exist when 50 percent or more of one borrower's gross receipts or gross expenditures (on an annual basis) result from transactions with a related borrower. The test for substantial financial interdependence focuses on intercompany transfers of funds, whether in the form of fees paid for goods or services, or inter-company loans, dividends and other distributions to owners, capital contributions and similar payments.

A variation on this type of common enterprise is the situation where a lender lends to separate persons to finance the acquisition of a business enterprise. When a lender finances the acquisition of more than 50 percent of the voting interests of a business enterprise, even though the lender has made separate loans to each investor, a common enterprise is considered to exist among the separate borrowers and the loans must be aggregated for lending limit purposes.

Conclusion
Despite the fact that the loan combination rules are required under a federal regulation, a lender should consider these tests as an issue of best practices as part of its standard lending limit analysis procedures. If applied objectively and accurately, these tests may help the lender avoid a drain on its capital because of over-reliance on a group of related borrowers.

<back to July 2015 Lending & Credit Digest>

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