**Comptroller of the Currency**
**Administrator of National Banks**

Washington, DC 20219

**Interpretive Letter #863**
**August 1999**
**12 USC 84d2**
**12 CFR 32.5**

July 22, 1999

Re: [ ] National Bank, [ *City, State* ]/12 U.S.C. § 84

Dear [ ]:

This is in response to your June 14, 1999 letter to Eric Thompson, Director, Bank Activities and Structure Division, and our related telephone conversation on July 20, 1999 regarding certain loans made by your client, [ ] National Bank, [ *City, State* ] ("Bank") to six individuals who subsequently used the proceeds to invest in a limited liability company. You request that the OCC not object to your view that although the total amount of the six loans would exceed the Bank's legal lending limit under 12 U.S.C. § 84, the loans need not be combined under the OCC's lending limit regulation at 12 C.F.R. Part 32 because the loan attribution rules in 12 C.F.R. § 32.5 are inapplicable to the situation you have described.

## FACTS

You have presented the facts as follows.

In September 1997, the Bank extended unsecured lines of credit to six individuals, each of whom used the proceeds to invest in a new limited liability company, [ ] ("*LLC*"), which was organized to acquire, own and operate commercial real estate. Combined, the borrowers hold 100 percent of the membership interests in [ *LLC* ].

Each of the six borrowers is a longstanding Bank customer with a significant net worth. The Bank's decision to make each of the loans was based on the individual creditworthiness of the particular borrower. The loans are neither guaranteed nor collateralized by [ *LLC* ] and repayment is the responsibility of the individual borrowers. As members of a limited liability company, the borrowers have no liability beyond their initial contributions. Since the source of repayment is not the revenues of [ *LLC* ], the Bank is not dependent on [ *LLC* ]'s performance.

The legal lending limit for the Bank under 12 U.S.C. § 84 as of March 31, 1999 was $2,259,000. If the loans are aggregated, the draws for the lines of credit exceeded this amount by $323,000.

**DISCUSSION**

All loans and extensions of credit made by national banks are subject to statutory legal lending limits. Generally, the total loans and extensions of credit to any one borrower may not exceed 15 percent of the bank's total unimpaired capital and unimpaired surplus. 12 U.S.C. § 84(a). The statute "is intended to prevent one individual, or a relatively small group, from borrowing an unduly large amount of the bank's deposits for the use of the particular enterprises in which they are engaged." OCC Interpretive Letter No. 15 (January 10, 1978), *reprinted in* [Transfer Binder 1978-79] Fed. Banking L. Rep. (CCH) ¶ 85,090. OCC regulations promulgated pursuant to section 84 describe the purposes of the lending limit as "protect[ing] the safety and soundness of national banks by preventing excessive loans to one person, or to related persons that are financially dependent, and [promoting] diversification of loans and equitable access to banking services." 12 C.F.R. § 32.1(b).

OCC lending limit regulations require that loans or extensions of credit to one person be attributed to other persons when (1) the proceeds are used for the "direct benefit" of the other person, or (2) a "common enterprise" is deemed to exist between the persons. 12 C.F.R. § 32.5(a).

**Common Enterprise Rule**

Under 12 C.F.R. § 32.5(c), loans to different borrowers will be aggregated if a "common enterprise" is found to exist between or among the borrowers. There are three *per se* rules under which a "common enterprise" may be found to exist. In addition, a common enterprise will be found if the facts and circumstances of a particular transaction support that conclusion.

Only one of the three common enterprise tests is relevant to this situation. Under 12 C.F.R. § 32.5(c)(3), a common enterprise will be deemed to exist among different borrowers "[w]hen separate persons borrow from a bank to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests…."

Your letter makes clear that all six borrowers invested their loan proceeds in [ *LLC* ], and among them they own 100 percent of the company. It is your contention, however, that a common enterprise should not be deemed to exist under the circumstances because the borrowers are all independently responsible for repayment of their loans, the loans are not collateralized or guaranteed by [ *LLC* ], and repayment of the loans is not dependent on the success or revenues of [ *LLC* ]. You suggest that since the Bank made the loans based on separate credit evaluations of the borrowers, all of whom are of high net worth and therefore presumably capable of repayment, the Bank is not dependent on the success of [ *LLC* ] for repayment of the loans. Therefore, you believe that the risk to the bank is minimal and that the statutory goal of the lending limit -- to protect the safety and soundness of national banks -- is not furthered by aggregating the loans to the six borrowers.

I am unable to agree with your suggestion that 12 C.F.R. § 32.5(c)(3) should apply only where the borrowers are financially interdependent or where the source of repayment is dependent on the proceeds of the business enterprise. On the contrary, the OCC has repeatedly stated that the creditworthiness of particular borrowers is not determinative in applying the loan aggregation rules so as to further the statutory purposes of safeguarding bank deposits and spreading loans among a large number of persons engaged in diverse lines of business.

For example, in 1978 the OCC required that loans to two different individuals who purchased interests in a corporation be aggregated, stating that the purposes of the statutory lending limits were applicable to the individuals "irrespective of their ability to repay the loans" and further that "in light of the purpose of 12 U.S.C. § 84, the fact that the bank will make the loans to both [borrowers] *on the basis that they have sufficient assets to repay the loan does not alter the legal requirement of the statute*." OCC Interpretive Letter No. 15, *supra*, CCH ¶ 85,090 at 77,083 (emphasis added).

In an unpublished 1991 letter, the OCC reiterated its view that the separate creditworthiness of individual borrowers does not bar the finding of a common enterprise when their separate loan proceeds are used in the acquisition of a business. In that instance, aggregation of the loans was required notwithstanding that the bank in question was "satisfied with the creditworthiness of each borrower and expect[ed] repayment of the loans from the individuals and not from income from the holding company…." OCC letter from Suzanne Rogers (November 7, 1991) (unpublished).

Your letter makes clear that the six borrowers all used the entire proceeds of their respective loans to invest in a newly-organized limited liability company. The six collectively own the entire company. It is clear that these individuals borrowed from the Bank "to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests" and that therefore they are engaged in a common enterprise within the meaning of 12 C.F.R. § 35.5(c)(3). The fact that the loans are not secured or collateralized by [ *LLC* ] assets is not a relevant factor in reaching this conclusion, nor is the independent creditworthiness of the borrowers. As noted above, one of the goals of the lending limits prescribed in 12 U.S.C. § 84 is credit diversification: ensuring that a national bank provides credit to the community as a whole rather than to a select group of individuals or business entities. This goal is frustrated if a bank has excessive amounts of its capital tied up in a single business.

**Direct Benefit Rule**

Your letter also briefly refers to the "direct benefit" rule of loan aggregation as stated in 12 C.F.R. § 32.5(b). Under the direct benefit rule, the proceeds of a loan will be deemed to be for the "direct benefit" of another person when the proceeds, or assets purchased with the proceeds, are transferred to another person, other than in a bona fide arm's length transaction where the proceeds are used to acquire property, goods, or services. 12 C.F.R. § 32.5(b).

There are certain circumstances under which the direct benefit rule of loan aggregation might be applicable to the use of loan proceeds to purchase interests in a newly-organized company. However, since it is clear that the loans in question were used in a common enterprise for the acquisition of a business and therefore must be aggregated under 12 C.F.R. § 32.5(c)(3), it is not necessary to consider whether the loans would also have to be aggregated under the direct benefit rule of 12 C.F.R. § 32.5(b).

**CONCLUSION**

Since the six individuals described in your letter used all loan proceeds to invest in and acquire more than 50 percent of a business enterprise, it is my view that they were engaged in a common enterprise within the meaning of 12 C.F.R. § 32.5(c)(3) and that the loans must therefore be aggregated in determining the Bank's lending limits under 12 U.S.C. 84(a).

Please do not hesitate to call me at (202) 874-5300 if you have any questions.

Sincerely,

/s/

Sue E. Auerbach
Senior Attorney
Bank Activities and Structure Division