

INTERPRETIVE LETTER No. 01-03 (July 9, 2001)

A loan to the shareholders of a corporation or to another business entity owned by those shareholders is not aggregated with the borrowings of the corporation, unless the Bank is looking to the corporation for repayment.

This is in response to your inquiry to the Office of Banks and Real Estate (“Agency”) asking whether a loan from * (“Bank”) to a corporation would be aggregated with a proposed loan to the individual shareholders of that corporation or to another business entity owned by the same individuals. You have presented three possible scenarios for the proposed loan that will be addressed in turn. Based upon the information you have provided, aggregation of the loans would not be required under any of the structures you have proposed, subject to the conditions in this letter.

The Bank currently has provided loans and credit to * (“Corporation”) in the amount of \$2,243,000. These loans and credits consist of a fully funded line of credit in the amount of \$1,500,000 and term loans in the amount of \$743,000. These loans are backed by payment guarantees of Corporation’s owners, John and Jane Doe. John Doe owns 90% of the outstanding shares of Corporation. The Bank’s legal lending limit is \$3,000,000.

The Bank is now considering funding another loan in the amount of \$1,972,000 for the purchase of a manufacturing plant for Corporation. The borrower(s) on this proposed loan would be either: 1) John and Jane Doe; 2) Trust 101 (John and Jane Doe, beneficiaries); or 3) Doe LLC (John and Jane Doe, members). The proposed loan would not be supported by any guarantees, but the manufacturing plant would secure the proposed loan. You have represented that this manufacturing plant facility has a current market appraised value of \$2,610,000. The borrower intends to lease the plant to Corporation for fair market value. You have also represented that if the proposed lease arrangement with Corporation fails during the life of the proposed loan, the debt could be serviced by the rental income of a replacement tenant. Your letter indicates that the anticipated rental income would be sufficient to service the debt.

Section 32 of the Illinois Banking Act (“Act”) prohibits the Bank from permitting any person’s outstanding liabilities to exceed the legal lending limit.¹ The provisions of Section 32 of the Act are intended to prevent one person or a relatively small group of persons from borrowing an unduly large amount of a bank’s funds and to diversify the risk of loan losses among a relatively large number of persons engaged in different types of businesses. The Act defines the term “person” to include corporations and trusts.² The Act’s definition of “person” does not specifically include a limited liability company (“LLC”). However, the Limited Liability Company Act defines “person” to include an LLC and establishes that an LLC is a legal entity that is distinct from its members.³ Based on these basic principles of Illinois law, the aforementioned entities are generally treated as separate persons for lending limit purposes. Thus, any one of the borrowers you have proposed would generally be treated separately under Section 32 of the Act, unless the rules of aggregation apply.

1 205 ILCS 5/32.

2 205 ILCS 5/2.

3 805 ILCS 180/1-5; 805 ILCS 180/5-1(c); 805 ILCS 180/10-10(a).

The circumstances under which a loan to a corporation would be aggregated with its shareholder's borrowings or with another entity's borrowings are set forth in the Agency Rule on loan aggregation.⁴ In general, the rules of aggregation will be applied to a loan made to one person that is not justified without relying on the creditworthiness of another person. Relevant factors in this determination are: 1) Will the Bank's credit analysis and documentation substantiate that the borrower has the capacity from his, her, or its own assets and operations to repay the loan, or is the source of repayment the other person; and 2) Were the proceeds of the loan used for the primary benefit of the other person without a corresponding economic benefit to the borrower?

Your letter represents that each of the proposed borrowers would independently have sufficient financial capacity to service the debt and that the Bank would not rely on the creditworthiness of any other person. In order to support this position, the Bank's files must contain a current and accurate credit analysis and document that the borrower is creditworthy of the loan and has sufficient collateral and income to repay the obligation. Provided that the Bank has conducted the required credit analysis and obtained sufficient documentation to substantiate the extension of credit to any of the individual proposed borrowers, the outstanding loans to Corporation would not be aggregated with a loan to any of the proposed borrowers.

Although the transactions may not cause a lending limit violation, Agency examination staff could potentially note in an examination report that the loans constitute a concentration of credit to affiliated interests. Additionally, the Bank should establish procedures to ensure that the combined guarantees, borrowings, and other obligations of any one borrower do not exceed the respective limits specified in Section 32 of the Act.

⁴ 38 Ill. Admin. Code § 330 (Subpart B).