INTERPRETIVE LETTER NO. 01-05 (September 17, 2001)

A loan to a shell corporation will be aggregated with the borrowings of another corporation when the ultimate source of repayment is the other corporation.

This is in response to your inquiry to the Office of Banks and Real Estate, ("Agency") regarding proposed loans from * ("Bank") to * ("Corporation 1") and * ("Corporation 2"). Specifically, you inquired whether these proposed loans would be aggregated for lending limit purposes. Based upon the information that you provided, it is the Agency's position that aggregation of the loans would be required.

Both Corporation 1 and Corporation 2 are owned or controlled by * ("Shareholder"). A total of 80% of the corporate stock issued by Corporation 1 is owned or controlled by Shareholder. He also owns 100% of the corporate stock issued by Corporation 2. Your correspondence indicated that Corporation 1 seeks to obtain a $2,000,000 line of credit from the Bank. An additional loan to Corporation 1 in the amount of $1,000,000 is proposed. Corporation 2 seeks a separate loan in the amount of $420,000. The legal lending limit of the Bank is $3,259,000.

Shareholder will pledge marketable securities to secure the $1,000,000 term loan to Corporation 1, which will be released and replaced by Eligible Accounts Receivable under a Borrowing Base formula. Shareholder will also pledge marketable securities to secure the Corporation 2 loan. Corporation 2 intends to lend the $420,000 it borrows from the Bank to Corporation 1, taking back a note subordinated to the Bank. Corporation 2 is a shell corporation that will derive its sole source of income from the interest paid by Corporation 1 on the subordinated note.

The purpose of Section 32 of the Illinois Banking Act ("Act") is to prevent one person or a relatively small group of persons from borrowing an unduly large amount of a bank's funds at one time. The principles of aggregation for lending limit purposes are prescribed by Rule.[1] In general, loans or extensions of credit to different persons will be aggregated where the credit worthiness of only one person can justify the loans. Relevant factors in determination are: 1) Will the borrower have the capacity to generate sufficient funds from his or her 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?

Based on these factors, the combined borrowings of Corporation 1 and Corporation 2 would be considered a single obligation for lending limit purposes. Not only would Corporation 1 obtain the proceeds of the Corporation 2 loan, it would also serve as the primary source of repayment. Corporation 2 has no independent financial capacity to service the debt. Since the only source of Corporation 2's income would be derived from interest paid on the subordinated note, its ability to service the Bank loan would hinge directly on the continued success of Corporation 1. As a result, the Bank would, in fact, be relying on Corporation 1 as the single source of repayment on all three proposed transactions.

Moreover, although the borrowing entities are legally distinct, the corporations are so closely related that, in reality, they are indistinguishable as separate entities. Corporation 2 is merely a shell corporation having no economic substance except as a vehicle to benefit Corporation 1. In exchange for transferring all loan proceeds, Corporation 2 gains nothing except for interest payments on the subordinated note. Such interest payments do not

1 38 Ill. Admin. Code § 330 (Subpart B).

constitute a corresponding economic benefit to Corporation 2, because the funds will actually be used to service the Bank loan. Consequently, Corporation 2 stands in the position of a "straw" or "nominee" borrower for Corporation 1. Where such circumstances exist, the Agency has taken the position that aggregation of loans is appropriate.[2]

Although the principles of aggregation will apply to the extent of outstanding liabilities of Corporation 1 and Corporation 2, the Bank may be able to consummate all three transactions without violating the lending limit. Section 32 prohibits the Bank from maintaining *outstanding* liabilities in excess of the limit. The $2,000,000 proposed line of credit to Corporation 1 would only constitute an outstanding liability to the extent to which it is drawn upon. Thus, the Bank can prevent a violation of Section 32 if the line of credit contains an irrevocable commitment by another bank to purchase or participate out any amounts that, if drawn, would create a loan in excess of the limit. Your letter did not indicate whether the line of credit would contain such a commitment or participation.

Additionally, the Bank may apply a higher lending limit, up to 30% of its unimpaired capital and unimpaired surplus, depending on the amount and type of marketable securities to be pledged on the loans. Section 32 provides an exception to the traditional lending limit provided that "the excess amount from time to time outstanding is fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available quotations, at least equal to the excess amount outstanding… " Your inquiry does not provide enough information regarding the type and amount of those securities to determine whether they qualify under the exception.

In conclusion, the proposed transactions would be aggregated to the extent of outstanding liabilities. There is insufficient information regarding the line of credit and the securities to be pledged on the loans to determine whether the transactions will result in a violation of Section 32 of the Act.

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2 Interpretive Letter 90-02 (January 29, 1990).