INTERPRETIVE LETTER 93-013 (JULY 30, 1993)

Lending limits applicable to aggregate guarantees are determined by the forms of the guarantees; guarantees of payment are limited to 20% of unimpaired capital plus 20% of unimpaired surplus, calculated separately from the lending limit; guarantees of collection are limited to 25% of deposits, but may not be more than 50% of unimpaired capital and surplus, calculated by adding such guarantees together with all other liabilities of the guarantor to the bank.

We are writing in response to your inquiry to the Illinois Commissioner of Banks and Trust Companies ("Commissioner") concerning the applicable lending limits to the guarantee program described below. You have informed us that * ("Bank") proposes to participate in a loan program to assist Russian immigrants in the Chicago area ("Program"). The Bank will make loans to unrelated, individual borrowers who meet the Bank's customary underwriting standards. The loans will be guaranteed by the * ("Guarantor"). Although the State of Illinois is encouraging the Program by proposing to deposit public funds with the Bank, the State is not guaranteeing the loans. You have indicated that the aggregate amount of the guarantees by the Guarantor will be approximately * million dollars and that your lending limit is * million dollars. You asked what lending limit applies to the aggregate guarantees by the Guarantor.

Section 32 of the Illinois Banking Act ("Act"), 205 ILCS 5/32 (1992) [Ill. Rev. Stat. ch. 17, par. 339], sets forth limitations upon the total liability to a state bank of a person as a guarantor. The particular lending limit applicable to the aggregate guarantees of a guarantor depend on the form of the guarantees. If the guarantees are guarantees of payment, a lending limit of 20% of the Bank's unimpaired capital plus 20% of the Bank's unimpaired surplus will apply. If the guarantees are guarantees of collection, a lending limit of 25% of the Bank's deposits or 50% of its unimpaired capital and unimpaired surplus will apply.

Section 32 of the Act provides that "the liabilities to any state bank of any person for money borrowed...shall at no time exceed 20% of the amount of the unimpaired capital of such bank and 20% of its unimpaired surplus." Section 32 further provides that certain obligations are not "money borrowed" for purposes of this basic lending limit. Pursuant to Section 32(5), the total liabilities to any state bank of a person as a "guarantor of payment" is not "money borrowed" and therefore is subject to a separate "guarantee" limit, as opposed to a lending limit. That limit is 20% of the bank's unimpaired capital plus 20% of its unimpaired surplus, which is calculated separately from the bank's lending limit for that person. Finally, Section 32(6) excludes from the term "money borrowed" the liabilities of a person who "guarantees collection of the obligation" of another person. When Section 32(6) is applicable, the "guarantee" limit of a person is 25% of a bank's deposits, but in no event more than 50% of the bank's

unimpaired surplus and capital, which is calculated by adding such guarantees to all other liabilities of the guarantor to the bank.

To determine the type of guarantee, the language of the guarantee and the resulting obligations will control. The Illinois Uniform Commercial Code ("UCC") makes a distinction between a guarantee of collection and a guarantee of payment. Section 3-419(d) of the UCC, 810 ILCS 5/3-419 (1992) [Ill. Rev. Stat. ch. 26, par. 3-419], defines when a party guarantees collection:

> If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the party whose obligation is guaranteed.

Prior to January 1, 1992, Section 3-416 of the UCC provided that the term "payment guarantee," when added to a signature, meant that the guarantor would pay the instrument when due without resort by the holder to any other party. The UCC provisions governing guarantees were amended and recodified as Section 3-419, effective January 1, 1992. Although the statutory definition of the term "payment guarantee" was eliminated, Section 3-419 continues to describe the legal obligations that arise when the signature of a party unambiguously indicates a guarantee of collection as opposed to when a "payment guarantee" is the primary obligation. In Beebe v. Kirkpatrick, 321 Ill. 612, 616 (1926), the Illinois Supreme Court clarified the distinction between a collection guarantee and a payment guarantee in a similar manner as follows:

> A contract guaranteeing the collection of a note or debt is conditional in its character, and the guarantor thereby undertakes to pay the debt upon condition that the owner thereof shall make use of the ordinary legal means to collect it from the debtor with diligence but without avail. A contract guaranteeing payment of a note or a debt is an absolute contract, and by it the guarantor undertakes, for a valuable consideration, to pay the debt at maturity if the principal debtor fails to do so, and upon it, if the debt is not paid at maturity, the guarantor may be sued at once.

Pursuant to the above analysis, if the Guarantor's obligations under the Program are primary or if its intent is ambiguous, its guarantees will be deemed to be payment guarantees. The payment guarantees will then be aggregated with any other of the Guarantor's payment guarantees of loans made by the Bank, and therefore are limited to 20% of unimpaired capital plus 20% of unimpaired surplus, or approximately * million dollars. If the signature of the Guarantor

clearly and unambiguously indicates that the guarantees are collection guarantees, then the applicable limit will be 25% of deposits, but not more than 50% of unimpaired capital and surplus. In applying this limit, any direct loans to the Guarantor and any other collection and payment guarantees will be aggregated with the collection guarantees made under the Program.