INTERPRETIVE LETTER 93-021 (OCTOBER 28, 1993)

For determination of lending limits, language of guarantee must clearly identify guarantee as one of collection or guarantee will be deemed a guarantee of payment.

Earlier this year, * ("Bank") exchanged correspondence with * of this Agency with respect to a certain draft guaranty. The guaranty is to be given to Bank by * to guarantee the indebtedness of two Subchapter "S" corporations wholly-owned by *. In a letter from this Agency dated *, we advised Bank that *'s guaranty of payment would violate Section 32 of the Illinois Banking Act, 205 ILCS 5/32 (1992) [formerly Ill. Rev. Stat. ch. 17, par. 339 (1991)], if * guaranteed the payment of the indebtedness of the two corporations. An individual may guarantee the payment of any indebtedness to a state bank up to a maximum of 20% of the bank's unimpaired capital and unimpaired surplus. We also informed Bank that if * guaranteed the collection of the indebtedness, then the guarantees would not violate Section 32, as the limitation on guarantees of collection is 25% of a bank's deposits, but in no event more than 50% of a bank's unimpaired capital and unimpaired surplus, which is calculated by adding such guarantees to all other liabilities of the guarantor to the bank.

After Bank received *s' letter, Bank sent a revised copy of the draft guaranty to *. Language had been added to the original draft of the guaranty providing that, notwithstanding other provisions in the guaranty to the contrary, the guaranty would be enforceable only upon a default in a Floor Plan Financing Agreement. By sending the revised draft of the guaranty, Bank was asking this Agency if the guaranty would now be treated as a guaranty of collection and would entitle * to guarantee the indebtedness of the Subchapter "S" corporations up to 50% of Bank's unimpaired capital and unimpaired surplus.

Under Section 3-419(d) of the Uniform Commercial Code, 810 ILCS 5/3-419(d) (1992) [formerly Ill. Rev. Stat. ch. 26, par. 3-419(d) (1991)], the provisions which would govern the draft guaranty, a guaranty must clearly provide that the guarantor is only guaranteeing collection in order for the document to be a guaranty of collection. In the words of Section 3-419(d), the document must indicate "unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party...." Illinois case law is consistent with Section 3-419(d)'s provision that the nature of a document as a guaranty of collection be clearly recognizable from the guaranty's language. See Dillman v. Nadelhofer, 43 N.E. 378 (Ill., 1895); and Floor v. Melvin, 283 N.E.2d 303 (Ill. App. Ct. 1972). A guaranty that fails to clearly be identifiable as a guaranty of collection will be treated as a guaranty of payment.

The new language that was added to the draft guaranty offers no insight into whether * intends to guarantee the collection rather than payment of the debts of the Subchapter "S" corporations. If * intends to guarantee only the collection of the indebtedness of the two Subchapter "S" corporations, Bank should contact its legal counsel to discuss the

appropriate drafting of guarantees of collection, keeping in mind UCC Section 3-419(d) and Illinois case law addressing guarantees.