

**DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION**

**DIVISION OF BANKING**

**BUREAU OF BANKS AND TRUST COMPANIES**

**COMMERCIAL BANKING**

**ELIMINATING VIOLATIONS OF LAW PERTAINING TO LENDING, INVESTMENT,  
AND LEASE LIMITS**

1. A violation of Section 32 (pertaining to money borrowed) of the Illinois Banking Act ("Act") will cease to exist if the liabilities to a state bank of a person no longer exceed 25% of the unimpaired capital and unimpaired surplus as determined in accordance with the Act at the time the liabilities were incurred ("Statutory Limit"). This may occur in any of the following manners:
  - a. Such liabilities are reduced to an amount that is less than or equal to the Statutory Limit from payments;
  - b. Such liabilities are reduced to an amount that is less than or equal to the Statutory Limit by selling part or all of the liabilities to a third party without recourse;
  - c. The applicable Statutory Limit is increased to an amount equal to or greater than the amount of such liabilities; or
  - d. Such liabilities are secured to the extent required by Sections 34 or 35 of the Act to bring such liabilities into compliance with the Act or secured by readily marketable collateral pursuant to Section 32.
  
2. A violation of Section 32(3) shall occur if any of the following conditions are not satisfied at the time the liability is incurred:
  - a. The real estate securing the loan is productive real estate;
  - b. The lien securing the real estate is a first lien;
  - c. The real estate securing the debt is appraised by two qualified appraisers;
  - d. The qualified appraisers are not directors, officers or employees of the bank; or

- e. Both of the qualified appraisers certify that the value of the real estate securing the loan is double the value of the principal debt at the time of origination of the debt or at any subsequent renewal of the debt.

In the event any of the above conditions are not met, the purchase of or loaning money in exchange for evidences of indebtedness secured by such real estate shall be subject to the Statutory Limit, provided however that any condition that is technical in nature and which is readily corrected by a ministerial act shall cause the condition to be deemed satisfied and qualify the liability for a limit equal to 50% of the unimpaired capital and unimpaired surplus in effect at the time of the original purchase of the evidence of indebtedness or loan of money or renewal of the same. Ministerial acts may include, but are not limited to, the following: the addition of a certification to an otherwise complying appraisal, documentation of an appraiser's qualifications, recording of a previously obtained lien release.

- 3. A violation of Section 32(5) or 32(6) of the Act shall exist if the guarantee obligation is in excess of the applicable limit in effect at the time the obligation is incurred. A violation of Section 32(5) or 32(6) shall cease to exist when the liabilities to a state bank of a person no longer exceed the applicable limit. This may occur in any of the following manners:
  - a. Such liabilities are reduced to an amount that is less than or equal to the applicable limit from payments;
  - b. Such liabilities are reduced to an amount that is less than or equal to the applicable limit by selling part or all of the liabilities to a third party without recourse;
  - c. The applicable Statutory Limit is increased to an amount equal to or greater than the amount of such liabilities;
  - d. Such liabilities are secured to the extent required by Sections 34 or 35 of the Act to bring such liabilities into compliance with the Act; or
  - e. The accommodation party or guarantor is released from liability to the bank to an extent that such liability no longer exceeds the applicable limit.
- 4. A violation of Sections 33, 34, 35.1 or 35.2 shall cease to exist if the liabilities to a state bank of the person no longer exceed the limits set forth in the applicable section. This may occur in any of the following manners:
  - a. Such liabilities are reduced to an amount that is less than or equal to the applicable limit from payments;

- b. Such liabilities are reduced to an amount that is less than or equal to the applicable limit by selling part or all of the liabilities to a third party without recourse;
- c. Such liabilities are secured to the extent required by Sections 34 or 35 of the Act to bring such liabilities into compliance with the Act; or
- d. The applicable Statutory Limit is increased to an amount equal to or greater than the amount of such liabilities.

**FOR ADDITIONAL INFORMATION THE TRANSMITTAL FOR THIS GUIDELINE IS ATTACHED AS AN EXHIBIT AND SHOULD BE REVIEWED TOGETHER WITH THE GUIDELINE.**

*[Revised: October, 2005]*

## **ATTACHMENT**

October 13, 1994

Re: P.A. 88-546

Dear State Bank President:

Public Act 88-546 ("Act") became effective on June 29, 1994 ("Effective Date"). The Act amended Sections 2 and 32 of the Illinois Banking Act ("Banking Act") and radically changed the scope and method of calculating the lending limits applicable to state banks. As a result of this amendment, the Illinois Department of Financial and Professional Regulation, Division of Banks and Real Estate, Bureau of Banks and Trust Companies ("Agency") has received a number of questions concerning the interpretation of Section 32. In this letter, we have addressed most of the issues that your colleagues or you have raised concerning the interpretation and application of Section 32, as amended.

### Application of Lending Limit

1. As of the Effective Date, loans and other liabilities of a person that are within the lending limit when extended will not be deemed a violation of Section 32 if there is a subsequent decrease in the limit. Additionally, a subsequent merger of the borrowers or merger of the lenders that causes the liabilities of a person to a bank to exceed the limit shall not be deemed a violation of Section 32, if such loans and liabilities were within the limit when extended. Loans made prior to the

Effective Date that are within the lending limit as of the Effective Date will not be deemed a violation of Section 32 if there is a subsequent change in the lending limit.

Explanation: Prior to the Effective Date, Section 32 provided that the "liabilities to any state bank of any person...shall at no time exceed...." This language had been interpreted to require a continuous testing of outstanding loans and other liabilities. Therefore, even if a loan was within the lending limit when made, a subsequent change in the lending limit could have resulted in a violation. Section 32 now provides "the liabilities outstanding at one time to a state bank...shall not exceed...." This language was enacted to clarify that a loan that is within the lending limit when made would not be a violation if there is a subsequent decrease in the lending limit or borrowers merge or lenders merge, causing the liabilities of a borrower to be combined. This interpretation is consistent with P.A. 88-636, effective September 9, 1994 (HB 3611), which amends Section 39 of the Banking Act to provide that directors are not liable for a violation of Section 32 if the loans were within the lending limit when made but the lending limit subsequently decreases.

2. For violations of Sections 32, 33, 34, 35.1 and 35.2 of the Banking Act, if the violations did not cease to exist as of the Effective Date due to the increase in the lending limit, the bank may take the corrective actions set forth in the Examination Guideline: Eliminating Violations of Law Pertaining to Lending, Investment and Lease Limits ("Examination Guideline"), enclosed with this letter.

Explanation: The Act, by redefining the elements used to calculate unimpaired capital and unimpaired surplus, increased the amount of capital and surplus available for the lending limit calculations. Therefore, the higher limit as determined by the amended statute may eliminate the violation. If such violation does not cease to exist by application of the increased lending limit, then the violation continues unless eliminated in the manner set forth in the Examination Guideline. The fact that the Agency may not cite a violation that has ceased to exist because the lending limit has increased by operation of law or the bank has taken one of the corrective actions permitted by the Examination Guideline may not eliminate any potential liability of its officers, directors or employees under Section 39 of the Banking Act.

3. Loans to officers, directors, principal shareholders and their related interests must comply with the lending limit set forth in Regulation O. The applicable limit is 15% of unimpaired capital and unimpaired surplus as defined in Regulation O.

Explanation: Regulation O limits the amount of money that a bank may lend to an insider and to all related interests of that insider to an amount equal to the limit for loans to a single borrower established for national banks under 12 U.S.C. 84. National banks are limited to 15% of unimpaired capital and unimpaired surplus in the case of loans that are not fully secured and an additional 10% of unimpaired capital and unimpaired surplus in the case of loans fully secured by readily marketable collateral. If state law establishes a lending limit that is lower than the amount permitted by 12 U.S.C. 84, the

state law will apply. For purposes of Regulation O, unimpaired capital and unimpaired surplus is defined as "total equity capital" as reported on the most recent call report filed under 12 U.S.C. 1817(a)(3), any subordinated notes and debentures that comply with the requirements of the appropriate federal banking agency for inclusion in capital and are reported on the most recent call report, and any valuation reserves created by charges to income reported on such call report. Therefore, for purposes of compliance with Regulation O, the 15% limitation based on unimpaired capital and unimpaired surplus as defined in Regulation O applies, notwithstanding that a higher limit is available under Section 32. If you have any questions concerning the interpretation or application of Regulation O, you should contact the Federal Reserve Bank for your district or the FDIC.

#### Calculation of Lending Limit

1. The lending limit shall be determined based upon the call report figures on each final date the call report is due and apply to transactions on or after that date, unless the lending limit is required to be calculated more often.

Explanation: The Act added the definition of "unimpaired capital and unimpaired surplus" to Section 2 of the Banking Act and provided that such capital and surplus shall be calculated on the "basis of the date of the last quarterly call report filed with the Agency." We interpret this to mean the date that the call report is required to be filed, which is thirty days following the date of the last quarterly call report. Furthermore, for the period beginning on the Effective Date and ending on July 29, 1994, the lending limit shall be determined based on the March 31, 1994, call report. The term "unimpaired capital and unimpaired surplus" is defined as "the sum of the state bank's Tier 1 Capital and Tier 2 Capital plus such other shareholder equity as may be included by regulation of the Agency." The terms "Tier 1 Capital" and "Tier 2 Capital," which were also added to Section 2 by the Act, are defined by federal regulation. The Agency has also promulgated an emergency rule to add the portion of the allowance for loan and lease losses not already included in Tier 1 and Tier 2 Capital as part of unimpaired capital and unimpaired surplus.

2. Adjustments to shareholders' equity for unrealized holding gains or losses on securities available for sale ("FASB 115 Adjustments") should not be included in the determination of the lending limit until such time as the FDIC adopts final regulations to 12 C.F.R. Part 325 that require the FASB 115 Adjustments to be included.

Explanation: On December 29, 1993, the FDIC proposed an amendment to 12 C.F.R. Part 325, its regulations for determining regulatory capital, to explicitly recognize FASB 115 Adjustments as a component of common stockholders' equity. Since common shareholders' equity is included in the calculation of Tier 1 Capital, the FDIC's proposed amendments, if adopted, will affect the calculation of Tier 1 Capital for purposes of determining the lending limit. The Agency has determined that notwithstanding the definition of unimpaired capital and unimpaired surplus in Section 2 of the Banking Act,

which permits the inclusion of other shareholder equity in the calculation, the Agency will not include the FASB 115 Adjustments to shareholders' equity in the calculation of Tier 1 Capital until the FDIC's proposed amendment to Part 325 is adopted.

### **Agency Rules and Guidelines**

1. Section 330.20 of Title 38 of the Illinois Administrative Code provides:

A renewal of a loan or extension of credit shall not be deemed to be a new loan or extension of credit except in instances when interest on the renewed loan or extension of credit is capitalized.

The Agency has determined that this rule is still applicable. However, the Agency has consistently determined that when new funds are advanced, the loan or extension of credit is not a "renewal."

2. Examination Guideline: Eliminating Violations of Law Pertaining to Lending, Investment and Lease Limits.

The Examination Guideline sets forth a number of methods by which a bank could cause violations of the lending limits under Section 32 and the loan, lease and investment limits under Sections 33, 34, 35.1 and 35.2 to cease to exist. For these sections of the Banking Act, the Agency continues to recognize that only the portion of a liability that exceeds the lending limit at the time the liability is incurred requires corrective action. A copy of the Examination Guideline is enclosed with this letter. We welcome any comments that you may have on the Examination Guideline or any of the other issues that are the subject of this letter.