



Office of the State Bank Commissioner

Regulatory Mailing

RM2009-01

TO: All State-Chartered Banks
From: J. Thomas Thull, Bank Commissioner
Date: January 26, 2009

Re: K.S.A. 9-1104, Legal Lending Limit Combination Rules and Common Enterprise

The purpose of this memorandum is to discuss the Legal Lending Limit requirements of K.S.A. 9-1104(f)(3)(A), Combination Rules, specifically the determination of common enterprise.

Pursuant to the above-cited section of the lending limit statute, a common enterprise is deemed to exist and loans to separate borrowers will be aggregated when the expected source of repayment for each loan or extension of credit is the same for each borrower and neither borrower has another source of income from which the loan, together with the borrower's other obligations, may be fully repaid.

The Office of the State Bank Commissioner (OSBC) has considered this section of the statute (as well as paragraph (f)(6) of the statute, which allows the Commissioner additional discretion to find that debts should be combined) and determined that if a bank has non-affiliated loans on the books, but the loan payments for each entity are derived from a general account of a third party or financial institution, the non-affiliated loans may be deemed a common enterprise and the debt would be aggregated for legal lending limit purposes.

Situations where this could apply include loan participations where the lead institution or third party is collecting payments from various debtors into a general account and then applying the payments to the participant(s) out of the general account. This situation could also apply to the purchase of leases where various lessee payments are collected by the leasing company and placed into a general account and the leasing company then distributes payments to the bank(s) out of the general account. In both of these scenarios, the payments are being distributed to the banks at the sole discretion of the lead institution or third party.

The primary issue is whether a lead institution or third party is collecting a debtor's payment and properly allocating the same payment proportionately and directly to the debtor's debt. Based on recent events, the OSBC has a concern when payments are aggregated into a general account and distributed by someone other than the debtor. The manner of distribution may not be consistent with the debtor's intention that their specific loan payment be applied to their specific loan.

If payments are not being applied as intended by the debtor, a situation could arise where a bank might have a past due loan where the borrower actually made their payments, or a bank might have a current loan where the borrower did not make their payments. In either case, credit risk is increased because it will prove difficult for bank management to properly identify the true condition

of the borrower.

The OSBC is requesting bank management be cognizant of and research situations where the collection and distribution of payments are pooled. If bank management determines the expected source of repayment for non-affiliated borrowers is tied to the same repayment source, the debts should be combined for legal lending limit purposes. In the case of an aggregated account, unless adequate records are kept to show that a particular borrower's payment is being applied to their specific loan upon receipt of that payment into the aggregated account, the position of OSBC examination staff will be that the non-affiliated borrowers' payments are coming from the same repayment source (the aggregated account), and their debts will be combined.

The combination of debt in these scenarios will limit exposure to the bank and should assist in identifying and decreasing the associated credit risk. If you have any questions, please contact your Review Examiner at 785-296-2266.