

Insights

June Hoosier Banker: Compliance Connection with Partner Brett Ashton

June 9, 2016

By: Brett J. Ashton

As seen in the June issues of the Indiana Banker Association's Hoosier Banker

Question No. 1: Does Indiana law limit how much a bank can lend to one borrower, or to a group of associated borrowers, at a time?

Answer: Yes, although the calculation of these limits will vary, based on the nature of the credit and collateral involved. As a general rule, Indiana law provides that the total loans and extensions of credit by a bank to a person outstanding at one time not fully secured by collateral having a market value at least equal to the amount of the loan or extension of credit may not exceed 15 percent of the unimpaired capital and unimpaired surplus of the bank.¹ Loans and extensions of credit fully secured by readily marketable collateral with a market value at least equal to the amount of the funds outstanding may account for an additional 10 percent of the unimpaired capital and unimpaired surplus of the bank.²

Question No. 2: How do I calculate loan limits under Indiana law when a borrower has personal loans in his or her name, and then business loans with other individuals?

Answer: Calculation of loan limits with multiple parties involved can be complex, and is not addressed directly in the Indiana code. Rather, Indiana law provides that the Department of Financial Institutions (DFI) may apply the provisions of 12 CFR § 32 ("Part 32") in the application and administration of the chapter governing loan limits.³ Indiana Code § 28-1-13-13 provides the DFI with general authority to apply the provisions of 12 CFR § 32 in the application and administration of loan limit restrictions under Indiana law, and provides the DFI flexibility to implement the provisions of Part 32 to the fullest extent, including in the event of changes to the federal law. This section of federal law includes the "Combination Rule" regulating the calculation of loan limits when dealing with multiple loans for the same borrower that may also involve other related parties.⁴ In general terms, the Combination Rule provides that loans or extensions of credit to one borrower will be attributed to another person, and each person will be deemed a borrower for purposes of the loan limit calculation, based on two independent standards referred to as the direct benefits test and the common enterprise test. The direct benefits test provides that the proceeds of a loan or extension of credit to a borrower will be deemed to be used for the direct benefit of another person and will be attributed to the other person when the proceeds, or assets purchased with the proceeds, are transferred to another person, other than in a bona fide arm's length transaction where the proceeds are used to acquire property, goods or services.⁵ The common enterprise test provides that a common enterprise exists, and loans to separate borrowers will be aggregated when either 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, or when loans or extensions of credit are made to borrowers who are related

directly or indirectly through common control, including where one borrower is directly or indirectly controlled by another borrower and substantial financial interdependence exists between or among the borrowers. A common enterprise is also present when separate persons borrow from a national bank or savings association to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests.⁶ Additional standards apply for interpretation of the common enterprise test with respect to partnerships, joint ventures and associations.⁷ The DFI has authority to deem the failure of any bank or trust company to comply with the loan limitations provision, or any order related to these limitations, as an indication that the bank is conducting its business in an unauthorized or unsafe manner, and to initiate liquidation proceedings of the institution in accordance with Ind.

Code § 28-1-3.1. It should be noted that the DFI has indicated that it attempts to maintain consistency between state lending limits and those applicable to national banks under 12 CFR § 32. t

1 Ind. Code § 28-1-13-1.5(a)

2 Ind. Code § 28-1-13-1.5(b)

3 Ind. Code § 28-1-13-13

4 12 CFR § 32.5

5 12 CFR § 32.5(b)

6 12 CFR § 32.5(c)

7 12 CFR § 32.5(e)