State of Washington
DEPARTMENT OF FINANCIAL INSTITUTIONS
P.O. Box 41200 · Olympia, Washington 98504-1200
Telephone (360) 902-8700 · TDD (360) 664-8126 · FAX (360) 586-5068 · http://www.dfi.wa.gov

Joseph M. Vincent, General Counsel
Direct: 360.902.0516
Mobile: 360.970.4699
E-Fax: 360.704.7036
Email: jvincent@dfi.wa.gov

REVISED ISGC-2007-009-DOB

August 1, 2007

[redacted]

Re: Combining Loans to Separate Borrowers – Limited Partnership Interests

Dear [redacted]:

Pursuant to your request, the Division of Banks of the Washington State Department of Financial Institutions ("Division") has been asked to consider whether a certain loan made by [redacted] Bank ("Bank") to a limited partnership would be combined with loans to one of the limited partnership's limited partners. Based on your representations which are reiterated below, the Division concurs that the loans in question to the limited partnership would not be combined with the loans of the limited partner for purposes of the Washington Lending Limit Statute, at RCW 30.04.111.

1.0 Bank's Representations

You have made the following representations on behalf of Bank, upon which the Division now relies in making the determination set forth in this letter:

- The Bank, a Washington state-chartered commercial bank, closed a loan in [redacted] to a Washington limited partnership (the "LP") in the amount of $10 million (the "Loan"). The general partners for LP are individuals "A" and "B" (referred to collectively as the "GPs"). "A" and "B" are the only guarantors for this loan and each signed a guaranty. The purpose of the loan was to purchase a 24+ acre site and to develop it into residential lots.

- LP was formed in 1990. In 1994, the GPs executed an "Assignment of Limited Partnership Units" of LP to the benefit of the children of "A," one of which is "Aa." "Aa" signed this document as a limited partner. The passive, beneficial interest of "Aa" in LP is 8.75%. "Aa" is not involved in the management or operation of LP and as such does not receive any remuneration from LP except for his share of distributions as a passive investor. "Aa" has not executed a guaranty for the Loan.

- Bank has a lending relationship with "Aa" as well. The loans are primarily for land development to various entities in which "Aa" is involved. He also has a significant portfolio of single family rentals which secure the loans with the Bank as well as a few miscellaneous lines of credit. The total sum of the outstanding loans to "Aa" and his controlled entities do not exceed the Bank's lending limit.

- In the apparent absence of any facts to the contrary:
  - The expected source of repayment for the Loan to LP would proceeds from the sale of the 24+ acres of developed tracts of land;
  - Bank does not appear to be relying upon the land development activities of "Aa" for repayment of the Loan;
  - The profits from the sale of assets in the LP are not being relied upon by "Aa" for loans incurred by "Aa";
  - The proceeds of loans to separate borrowers were not used to acquire a common business;
  - The loans to the enterprises of "Aa" were used in other unrelated enterprises; and
  - "A" and "Aa" are not acting in concert to control their respective enterprises.

- Independent entities may be using a third-party common development company for administrative purposes, to which no loan has been made.

2.0 Issue Presented

Should the above-represented $10 million loan by Bank to the LP be combined for purposes of the Lending Limit Statute, at RCW 30.04.111, with the above-represented loans to "Aa" and his related entities?

3.0 Short Answer

No. Even though loans to a general partnership are considered loans to each member of the partnership, loans to a *limited partnership* are not aggregated in whole or in part to *limited partners*. Since "Aa" is a limited partner in LP, the $10 million loan to LP would not be combined with the loans to "Aa" and his related entities. This determination is based solely on the representations set forth in Section 1.0 above and is subject to the limitations set forth in Subsection 4.3.4 and Section 5.0 below.

4.0 Analysis and Discussion

Washington state chartered commercial banks are governed under Title 30 RCW and are regulated by the Director of Banks under delegated authority by the Director of the Washington State Department of Financial Institutions ("DFI"). Under RCW 30.04.030, the Director is granted broad administrative discretion to administer and interpret the provisions of Title 30 RCW.

Pursuant to the Lending Limit Statute, RCW 30.04.111, a Washington commercial bank's total outstanding loans to one borrower may not exceed 20 percent of the bank's capital and surplus. Loans to one borrower may be combined with loans to other borrowers under rules promulgated by the DFI in WAC 208-512-200 *et. seq.* acting under authority of RCW 30.04.111.

4.1 Special Rules Applicable to Partnerships and Limited Partnerships. There are specific rules that apply to partnerships in WAC 208-512-280. Generally, loans to a partnership are considered loans to each member of the partnership. WAC 208-512-280(1). However, there is an exception in subparagraph (3) pertaining to passive investors of *limited partnerships*:

> The rule set forth in subsection (1) of this section is ***not applicable to limited partners in limited partnerships*** or to members of joint ventures if such partners or members, by the terms of the partnership or membership agreement are not to be held liable for the debts or actions of the partnerships, joint venture, or association. However, the rules set forth in WAC 280-512-260(1) (*sic*) are applicable to such partners or members.

[Emphasis added.]

Based upon the above-referenced language of WAC 208-512-280(3), the Loan to LP would not be attributed to "Aa" solely on account of the limited partnership interest of "Aa" in LP. However, the Loan to LP could be attributed to "Aa" if (i) "Aa" is responsible for the Loan or (ii) any of the aggregation rules in WAC 208-512-260(1) apply. In other words, the Loan to LP could be attributed to "Aa" *if* (1) the proceeds of the loans or extensions of credit are to be used for the *direct benefit* of "Aa" or (2) when a *common enterprise* is deemed to exist between the LP and "Aa."

4.2 "Direct Benefit" Test. The "direct benefit" test in WAC 208-512-260(1)(a) is not defined in the rules. However, as the Legislature declared in RCW 30.04.111, in adopting rules, the Division "shall be guided by rulings of the comptroller of the currency that govern lending limits applicable to national commercial banks." Accordingly, the rules of the Office of the Comptroller of the Currency ("OCC"), at 12 C.F.R. § 32.5, and related OCC interpretations, are usually, as they are here, entitled to great weight Pursuant to 12 C.F.R. § 32.5 –

> ". . . the proceeds of a loan to a borrower will be deemed to be used for the ***direct benefit*** of another person and will be attributed to that other person when the proceeds, or assets purchased with such proceeds, are transferred to that other person, other than in a bona fide arm's length transaction where the proceeds are used to acquire property, goods or services."

[Emphasis added.]

Based upon Bank's representations made above, none of the proceeds of the loans to "Aa" and his enterprises were transferred or otherwise used by LP. Therefore, none of the "Aa" loans would be combined with the Loan to LP.[1] "Aa" does not *directly* benefit from the loan to LP and the proportional interest should not be otherwise aggregated with loans of "Aa."

4.3 <u>"Common Enterprise" Test</u>. Pursuant to WAC 208-512-260(2), a "common enterprise" is deemed to exist when:

- The expected source of repayment for each loan is the same;
- When separate borrowers use the loan proceeds to acquire more than 50% of a business enterprise; *or*
- The borrowers are related through "common control" *and* there is a "substantial financial interdependence" between or among the borrowers.

4.3.1 <u>Common Source of Repayment</u>. Based upon your representations, there appear to be no facts that support the conclusion that there is a common source of repayment for the loans. Rather, based upon your representations, it appears that the expected source of repayment for the Loan to LP would proceeds from the sale of the 24+ acres of developed tracts of land. Based as well on your representations, there appear to be no facts that Bank would be relying in any way upon the land development activities of "Aa" for repayment of the Loan. In addition, there are no representations that the profits from the sale of assets in the LP are being relied upon by "Aa" for loans incurred by "Aa."

4.3.2 <u>Borrowing to Acquire Control</u>. Based upon your representations, it does not appear that the proceeds of loans to separate borrowers were used to acquire a common business. The proceeds of the Loan to the LP was used to acquire the 24+ acre tract of land, and the loans to the enterprises of "Aa," as you have represented, were used in other unrelated enterprises.

4.3.3 <u>"Common Control" and "Significant Financial Interdependence"</u>. Borrowers are related by "common control" when one or more persons acting in concert directly or indirectly (1) own or control or have the power to vote 25% or more of any class of voting

---

[1] In an effort to be erudite, which the Division acknowledges and appreciates, you have discussed at length OCC Interpretive Letter #951 (Dated: 1/17/2002). However, the facts in OCC Interpretive Letter #951 are *distinguishable* from the facts involving LP and "Aa." As you have noted, arguably 8.5 percent of the Loan to LP *could* be combined with the loans of "Aa" using the reasoning in OCC Interpretive Letter #951 pertaining to Mrs. Mates' interest in certain land trusts. However, as represented, "Aa" does not have true ownership in the underlying property of the LP like Mrs. Mates had under Illinois law as pertains to an Illinois land trust. "Aa," on the other hand, has a passive, *intangible* interest in the LP.

securities of another person, (2) exercise a controlling influence over the management or policies of another person, or (3) control in a manner the election of a majority of the directors, trustees or other persons exercising similar functions of another person.

According to your representations, it does *not* appear that "A" and "Aa" are acting in concert to control their respective enterprises. Therefore, the Division cannot find any "common control" from the representations made above.

"Substantial financial interdependence" is presumed when 50% or more of one's gross receipts or gross expenditures (on an annual basis) are derived from transactions with one or more persons related through common control. However, based upon your representations, we cannot conclude that the Loan to LP ought to be combined with the loans to "Aa" simply because independent entities may be using a third-party common development company for administrative purposes, to which no loan has been made.[2]

4.3.4 "Facts and Circumstances" Always a Factor. Bank should be mindful that WAC 208-512-260(2), in setting forth the three-prong test outlined in Subsections 4.3.1, 4.3.2 and 4.3.3 above, also makes it clear that the absence of all three prongs only removes the *presumption* of a "common enterprise." So, while the Division has determined that based upon your representations there is no presumption of a "common enterprise" between LP and "Aa," the lack of such a presumption is not conclusive. A conclusive determination is still subject to "a realistic evaluation of the facts and circumstances of the particular transaction," which can only be made at a later date during the Division's review of the transaction during periodic examination of the Bank.

5.0 Concluding Remarks

The Division's conclusion, as set forth in this letter, is uniformly applicable to all Washington State-chartered commercial banks, similarly situated. However, the interpretations and conclusions we have made in this letter are limited only to the specific representations set forth in Section 1.0 above and are subject to the limitations set forth in Subsection 4.3.4 above. Therefore, we may in the future make dissimilar interpretations or conclusions based upon facts that are different than those represented by you with respect to Bank, "A" and "Aa." In addition, the interpretations and conclusions we have made in this letter are subject to future changes in statute and rule.

We understand that the representations upon which the Division has relied herein have been made in good faith by you. However, should any material representation made by Bank as set forth in Section 1.0 above be found in the future to be false or misleading, the conclusions we have reached in this letter shall not be binding upon the actions of the Division and shall have no prospective application.

---

[2] You have made the Division aware of *OCC Interpretive Letter #938* (Dated: 1/18/2001), and the Division appreciates your candor. However, the Division declines at this time to address whether it agrees with the reasoning of the OCC in OCC Interpretive Letter #938. Having found no "common control," the Division does not have to consider whether the facts and reasoning in OCC Interpretive Letter #938 are applicable to the issue of "substantial financial interdependence."

If you have any further questions, please do not hesitate to call upon the Division at (360) 902-8704.

Very truly yours,

WASHINGTON STATE DEPARTMENT
OF FINANCIAL INSTITUTIONS

By: Joseph M. Vincent
General Counsel

For Division of Banks