



IBAT Insights

(Ask IBAT Anything)

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The Independent Community Bankers Association of New Mexico

Question:

We need help determining the applicability of limits for guarantors as it relates to legal lending limits for a state bank as well as Regulation O restrictions.

Answer:

A question was added to the Regulation O FAQs on that topic in 2021. Regulation O considers any debt of a 'third-party' guaranteed by an 'insider' to be an extension of credit to that insider in the amount of the guarantee.

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12 CFR 215.3 (Extension of credit)

Q1: Would a guarantee by an insider for an extension of credit by a member bank to a third party be treated as an extension of credit to the insider?

A1: Yes. The definition of "extension of credit" in section 215.3(a)(4) of Regulation O includes any evidence of indebtedness upon which an insider may be liable as guarantor. 12 CFR 215.3(a)(4). The amount of such an extension of credit to the insider equals the amount of the indebtedness for which the insider has provided a guarantee.

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Source [link](#).

For the legal lending limit, 7 TAC 12.9 addresses what is a 'common enterprise' and in particular it is section (g) that addresses guarantors.

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(c) Common enterprise.

(1) A common enterprise is considered to exist and loans to separate borrowers will be aggregated in the case of:

(A) loans or extensions of credit made to affiliated borrowers if substantial financial interdependence exists between or among the borrowers; or

(B) loans made to separate persons for the purpose of acquiring more than 50% of the voting securities or voting interests of a business enterprise, in which case the acquisition loans are aggregated and attributed to the business enterprise.

(2) For purposes of paragraph (1)(A) of this subsection, borrowers are affiliated if one borrower directly or indirectly controls, is controlled by, or is under common control with another borrower. Substantial financial interdependence exists if 50% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower and is presumed to exist, subject to rebuttal, if 25% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues and expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments.

(d) Source of repayment. The expected source of repayment for each loan or extension of credit is considered the same if the primary source of repayment is the same for each borrower. An employer will not be considered a primary source of repayment under this subsection solely because of wages and salaries paid to an employee, unless the standards of subsection (c)(1) of this section are met.

(e) Loans to a corporate group. Pursuant to the Finance Code, §34.201(c), loans or extensions of credit by a bank to a corporate group may not exceed 60% of the bank's Tier 1 capital. This limitation applies only to loans subject to the general lending limit. For purposes of this subsection, a corporate group is comprised of a person and all of its subsidiaries, and a corporation or other entity is a subsidiary of a person if the person owns or beneficially owns directly or indirectly more than 50% of the voting securities or voting interests of the corporation or other entity. Subject to the special limit of this subsection, loans or extensions of credit to a person and its subsidiary, or to different subsidiaries of a person, are not aggregated or attributed to other members of the corporate group unless either the direct benefit, common enterprise, or source of repayment test is met.

(f) Loans to partnerships or partners.

(1) A loan or extension of credit to a partnership, joint venture, or association is considered to be a loan or extension of credit to each member of the partnership, joint venture, or association other than those partners or members that, by the terms of the partnership or membership agreement, are not held generally liable for the debts or actions of the partnership, joint venture, or association, provided those provisions are valid against third parties under applicable law, and that have not otherwise agreed to guarantee or be personally liable on the loan or extension of credit.

(2) A loan or extension of credit to a member of a partnership, joint venture, or association is generally not attributed to the partnership, joint venture, or association, or to other members of the partnership, joint venture, or association, except as otherwise required by subsections (b) - (d) of this section, provided that a loan or extension of credit made to a member of a partnership, joint venture or association for the purpose of purchasing an interest in the partnership, joint venture or association, is attributed to the partnership, joint venture or association.

(g) Guarantors and accommodation parties. The derivative obligation of a drawer, endorser, or guarantor of a loan or extension of credit, including a contingent obligation to purchase collateral that secures a loan, is not aggregated with direct loans or extensions of credit to such drawer, endorser, or guarantor if the lending bank is relying primarily on the creditworthiness of the primary obligor and none of the tests set forth in this section are satisfied. The reliance of the lending bank on the primary obligor must be evidenced by the certification of an officer of the bank that the bank is, on stated facts, relying primarily on the responsibility and financial condition of the primary obligor for payment of the loan or extension of credit and not on the guarantee, or commitment in whatever form, of the guarantor, drawer, or endorser. In the event that the loan or extension of credit to the primary obligor, considered by the bank to be of sufficient credit quality at its inception, experiences subsequent deterioration to the point that the primary obligor is no longer performing in accordance with the terms of the initial loan agreement, such event will not result in a lending limit violation on behalf of the guarantor by virtue of the primary obligor's nonperformance. However, the total amount of the deteriorated loans guaranteed by such accommodating person must be combined with all other obligations of such guarantor in determining whether the guarantor may obtain additional loans or extensions of credit from the bank.

Source [link](#).