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[redacted]

RE: Loans-to-One Borrower Rule and the "Direct Benefit Test"

Dear Mr. [redacted]

You have requested that the Division of Banks ("Division") interpret and reconcile federal and state law in regard to the so-called "Direct Benefit Test" of the "Loans-to-One Borrower Rule."

1.0 Background

Absent formal rule-making, the Division has for some time felt that certain isolated, but important, aspects of the "Loans-to-One Borrower Rule" remain problematic. One of these concerns is the so-called disparity in language between the federal version of the so-called "Direct Benefit Test," at 12 CFR 32.5, and the one formally adopted by the Division at WAC 208-512-260.

Washington State-chartered commercial banks have sometimes resolved certain "bank powers" issues by invoking the authority of a national bank under RCW 30.04.215(3). However, as we have stated many times before, one cannot invoke a "federal parity" statute [e.g., RCW 30.04.215(3)] and assume a particular "national bank power," without taking all limitations that are contained within that "national bank power." Therefore, because there are other aspects of the "Loans-to-One Borrower Rule" that are materially different as between federal and state law and regulation, one cannot rule out that, by invoking "federal parity" in relation to the "Direct

Benefit Test," one might be burdened by other, unintended or unwelcome aspects of the "Loans-to-One Borrower Rule." [1]

Consequently, without resorting to "federal parity," the Division is called upon to squarely interpret the meaning of RCW 30.04.111 and WAC 208-512-260(1)(a) so as to resolve, if possible, the disparity between national banks and Washington State-chartered banks with respect to the "Direct Benefit Test."

2.0 Question and Summary Determination

QUESTION: Shall the "Direct Benefit Test" under WAC 208-512-260 ("Washington Direct Benefit Rule") be interpreted consistent with the rules of the Office of the Comptroller of the Currency ("OCC"), at 12 CFR 32.5 ("OCC Direct Benefit Rule"), so that "direct benefit," pursuant to WAC 208-512-260(1)(a), shall be limited "to the extent of loan proceeds actually used"?

ANSWER: Yes. However, Washington State-chartered banks, prior to examination, shall adequately document and thereafter maintain records for the Division of Banks and its examiners how loan proceeds are actually used in the context of the "Direct Benefit Test."

3.0 Discussion and Legal Analysis

3.1 "Direct Benefit Test" for National Banks. The OCC Rules, at 12 CFR 32.5, declare, in part, as follows:

> (a) General rule. Loans or extensions of credit to one borrower will be attributed to another person and each person will be deemed a borrower-
>
> (1) When proceeds of a loan or extension of credit are to be used for the ***direct benefit*** of the other person, ***to the extent of the proceeds so used***.

[Emphasis added.]

Accordingly, under national bank regulatory policy, the "Attribution Rule" applies a "Direct Benefits Test" with the use of the language "to the extent of the proceeds so used." Presumptively, the "Direct Benefit Test" is of general application to *any* "person."[2] If the

[1] For instance, the Office of the Comptroller of the Currency ("OCC") limits "loans to one borrower" to 15% of capital and surplus. On the other hand, RCW 30.04.111 limits "loans to one borrower" to 20% of capital and surplus.

[2] However, the issue of "guarantors" and "loan guarantees" is one that we are not in a position to directly opine on in this interpretive statement. Several states take differing positions on this matter in fashioning their own "direct Benefit Tests." Indeed, there may be additional factors besides the ones we address in this interpretive statement that ought to bear on the subject of how the "Direct Benefit Test" should be applied to "loan guarantees." Therefore, without further research on the matter, we are *not* prepared at this time to opine that, if a "person" in question happens to be a guarantor, no attribution will be made to him or her of that portion of a loan that is not guaranteed.

proceeds directly benefit ***any*** "person," then proceeds of a loan actually used will be attributed to that "person." Conversely, portions of a loan not actually used will not be attributed to a "person."

3.2 Washington State "Direct Benefit Test". On the other hand, the Loans-to-One-Borrower Rule for Washington State-chartered commercial banks contains no such "Attribution Rule" or "Direct Benefits Test," as such. Rather, RCW 30.04.111 declares, in relevant part, as follows:

> "The total loans and extensions of credit by a bank or trust company to a person outstanding at any one time shall not exceed ***twenty percent*** of the capital and surplus of such bank or trust company. . .
>
> . . .
>
> "The term "person" shall include an individual, sole proprietor, partnership, joint venture, association, trust, estate, business trust, corporation, sovereign government or agency, instrumentality, or political subdivision thereof, or any similar entity or organization.
>
> The director may prescribe rules to administer and carry out the purposes of this section, including without limitation rules to define or further define terms used in this section and to establish limits or requirements other than those specified in this section for particular classes or categories of loans or extensions of credit, and ***to determine when a loan putatively made to a person shall, for purposes of this section, be attributed to another person***. In adopting the rules, the director shall be guided by ***rulings of the comptroller of the currency*** that govern lending limits applicable to national commercial banks."

[Emphasis added.]

In adopting rules consistent with the Legislature's grant of authority under RCW 30.04.111, the DFI adopted WAC 208-512-260, which declares, in relevant part, as follows:

> (1) ***Loans or extensions of credit to one person will be attributed to other persons when:***
>
> (a) ***The proceeds of the loans or extensions of credit are to be used for the direct benefit of the other person or persons;*** or
>
> (b) A "common enterprise" exists between the persons.[3]

[Emphasis added.]

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[3] The second prong of the "Direct Benefit Test" — known as "Common Enterprise" — is not the subject of this interpretive statement. See Footnote 11 below.

Absent from the language of WAC 208-512-260 are the words "to the extent of the proceeds so used," which appear in the OCC Rules, at 12 CFR 32.5(a)(1).

3.3 Federal Parity. Pursuant to 30.04.215(3), a Washington State-chartered commercial bank may invoke the powers that a national bank has as of July 23, 2003, which would include the OCC Rules, at 12 CFR 32.5(a)(1).

However, as we have opined several times before, if a state bank would invoke a power granted by Congress to a national bank, either directly or through the delegated authority of the OCC, it must bear any limitations or restrictions incumbent upon that power.[4]

In this regard, then, if a bank were to invoke "federal parity" to derive the benefits of all of 12 CFR 32.5(a)(1), it must bear the burden of being limited to 15% of capital and surplus with respect to the "Loans to One Borrower Rule in general, rather than relying upon the RCW 30.04.111 limits of 20% of capital and surplus.

Therefore, if we desire an outcome that applies the same "Direct Benefit Test" set forth in 12 CFR 32.5(a)(1), we must look for help to something other than "federal parity" as a means by which to achieve it.

3.4 Legislative Intent. The origin of Washington State's lending limit for state-chartered commercial banks predates 1986.[5] The present lending limit statute, at RCW 30.04.111, was enacted in 1986[6] and successively amended in 1994[7] and 1995.[8] In the same bill that amended RCW 30.04.111, the Washington Legislature also made it clear that it is interested in "maintain[ing] the fairness of competition and parity between state-chartered banks . . . and federally chartered banks."[9] In turn, we must presume that, in enacting or amending RCW 30.04.111, the Washington Legislature intended to act *reasonably* with regard to bank stakeholders.

Likewise, it would be *un*reasonable for us to take the position that, because the DFI did not add the words, "to the extent of the proceeds so used," in the drafting of WAC 208-512-260, that the Washington Legislature intended state-chartered banks to have a different "Direct Benefit Test" than that of national banks. The mere absence of this clause from WAC 208-512-260 does not mean that the Legislature intended to fashion a different "Direct Benefit Test" than

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[4] Our opinion is consistent with the final sentence of RCW 30.04.215(3), which states:

> "The restrictions, limitations, and requirements applicable to specific powers or authorities of federally chartered banks shall apply to banks or trust companies exercising those powers or authorities permitted under this subsection but only insofar as the restrictions, limitations, and requirements relate to exercising the powers or authorities granted banks or trust companies solely under this subsection."

[5] Previously the lending limit was codified at RCW 30.04.110.

[6] 1986 Washington Statutes, Chapter 279, Section 3.

[7] 1994 Washington Statutes, Chapter 92, Section 12.

[8] 1995 Washington Statutes, Chapter 344, Section 1.

[9] See 1995 Washington Statutes, Chapter 344, Section 2.

the one afforded national banks. Nor does its absence preclude our ability to look afresh at what the overall legislative intent of Title 30 RCW and to interpret our state commercial banking statute and our own administrative rules, in the interest of maintaining fairness of competition and parity with national banks.

Of course, while we recognize that an agency's own interpretation of the statutes that it administers is entitled to great weight,[10] we are mindful that, in adopting WAC 208-512-260, it will perhaps be said that the Division of Banks has already interpreted the statute and that we are, therefore, bound by the exact, unqualified language of WAC 208-512-260.

We disagree. The mere absence of qualifying language (i.e., ". . . only to the extent of the proceeds so used") does not preclude us from treating WAC 208-512-260 as if such language were present. It is not the Division of Banks' intent that is ultimately relevant, but rather the *Legislature's* intent. We do not believe that the Legislature would have us implement RCW 30.04.111 so as to be either unreasonable or deprive state-chartered banks of fairness of competition. A contrary interpretation of WAC 208-512-260 could significantly impact fairness of competition as between state-chartered banks and national banks in Washington State. Moreover, to "attribute" the entire loan to a "person" even if only 1% or even 10% of the proceeds of a loan are used, appears to us, in the case of the "Loans-to-One Borrower Rule," to be unreasonable and contrary to the presumption that the Legislature would have us act reasonably.

We, therefore, conclude (1) that the over-riding intent of the Washington Legislature has been to interpret Title 30 RCW through the prism of maintaining such fairness of competition and parity as between state-chartered banks and national banks. In this regard, then, we also conclude that, in the interest of this over-riding legislative intent and the general presumption of reasonableness, the authority granted under RCW 30.04.111, as expressed in WAC 208-512-260, shall be henceforward interpreted so that loans or extensions of credit to one person will be attributed to other persons when the proceeds of the loans or extensions of credit are to be used for the direct benefit of the other person or persons, ***but only to the extent of the proceeds so used***.[11]

We do not take this step lightly. Only in the most exceptional of circumstances, where to make a contrary interpretation would be manifestly unfair or unreasonable, will the Division Banks be inclined to interpret its administrative rules as if qualifying language existed that is, as a technical matter, absent therefrom. We conclude, however, that the present inquiry is appropriately exceptional in nature.

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[10] See, for example, *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-845, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984).

[11] In reaching this conclusion, we do not mean to exclude the other prong of the "Direct Benefit Test," which will attribute to a "person" a loan made to another "person" when a "common enterprise" exists between both persons. See WAC 208-512-260(1)(b) and (2). We believe that the "Common Enterprise" prong of Washington's "Direct Benefit Test" is more fully articulated in WAC 208-512-260(1)(b) and (2) and requires no further interpretation here.

3.5 Compliance. In the interest of assuring orderly and uniform application of this interpretation, compliance with it will require Washington State-chartered banks, prior to examination, to adequately document for the Division and its examiners how loan proceeds are actually used in the context of the "Direct Benefit Test."

However, absent any such documentation, if a "person" is deemed to have met the "Direct Benefit Test," then the *entire amount* of the loan will be attributed to such "person" for purposes of the "Loans-to-One Borrower Rule."

3.6 No Other Changes to WAC 208.512.260. As we have stated above in Subsection 3.4, our interpretation is the product of exceptional circumstances. Therefore, with the exception of this interpretation, WAC 208-512-260 shall, until further notice, be construed exactly as *otherwise* written and adopted.

5.0 Concluding Remarks

This interpretation is public record but may remain, at the option of the Director of Banks, unpublished.

This interpretation is of general application to all Washington State-chartered commercial banks similarly situated. If you have any questions, please do not hesitate to call upon Michael C. Abe, Program Manager for the Division of Banks.

Yours very truly,

WASHINGTON STATE DEPARTMENT
OF FINANCIAL SERVICES

By:
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For Division of Banks