



Comptroller of the Currency
Administrator of National Banks

Central District Office
440 South LaSalle Street, Suite 2700
Chicago, Illinois 60605

Interpretive Letter #955
12 USC 84
12 CFR 32.3(C)(10)

January 31, 2003

Dear []:

This is in response to your letter of December 2, 2002, in which you request the Office of the Comptroller of the Currency (“OCC”) to reconsider its determination that [**Bank**], [**City, State**] (“Bank”) had advanced funds to [] (“[]”) in excess of the legal lending limit in violation of 12 U.S.C. § 84. Your letter describes proposed modifications to the Bank’s loans to [] that you believe will result in those loans satisfying the exception to the lending limit for certain loans to leasing companies set forth at 12 C.F.R. § 32.3(c)(10).

For the reasons set forth below, the Bank’s loans to [] as modified under the proposal will satisfy the requirements of 12 C.F.R. § 32.3(c)(10). Accordingly, the loans to [], as modified, should be treated as loans to each lessee for the purposes of the legal lending limit

Background

[] is an equipment leasing company. The Bank has extended three non-recourse loans to [] to finance three pools of existing personal property leases. The original term of the leases in the pools is on average fifty-three months. The leases had been originated by [] between two and seventeen months prior to the Bank’s loans to []. [] financed its acquisition of the assets being leased through working capital or borrowings from other banks. The proceeds of the Bank’s loans to [] were used to reimburse it for the purchase of the leased equipment by restoring working capital or repaying the acquisition debt. The loans to [] are secured by an assignment of all of []’s rights to specified leases and security interests in the equipment being leased. The Bank has analyzed the creditworthiness of each lessee before making the loans to []. The Bank represents that the terms of the underlying leases meet the same limitations that would apply to a national bank acting as lessor. The assignment and security agreement provides that lease payments are to be made:

“by each Lessee to [[]], in care of [Bank], at [Bank’s] address set forth above and [[]] authorizes [Bank] to endorse, in [[]’s] name, all Lease Payments.”

However, in practice the lessees made their payments to [] and [] remitted the amount it owed on the promissory notes to the Bank on a monthly basis.

In the June 30, 2002 Report of Examination, the OCC cited the loans to [] as a violation of 12 U.S.C. § 84 since the aggregate amount of those loans exceeded the Bank’s legal lending limit. The examiners determined that the three loans to [] failed to satisfy the requirements of the lending limit exception at 12 C.F.R. § 32.3(c)(10) and noted that the lessees were making their lease payments to [], rather than to the Bank.

The Bank has proposed a modification to the manner in which lease payments are processed. Under the proposed modification, [] will open and maintain a lock box at the Bank and notify all lessees to direct all present and future payments due on the leases to the lock box. On the monthly payment due date, the Bank will deduct the amount of the monthly payment owed under the note and apply it to the [] loan. At the end of each month, the Bank will remit any funds remaining in the lockbox to []. [] will remain responsible for billing and collections, but will carry out these functions as an independent contractor and not as the Bank’s agent.

Legal Analysis

Generally, a national bank’s total outstanding loans or extensions of credit to one borrower may not exceed 15% of the bank’s capital and surplus, plus an additional 10% of capital and surplus if the amount over the 15% general limit is fully secured by readily marketable securities.¹ A “borrower” includes a person who is named a borrower or debtor in a loan or extension of credit.² “Loans or extensions of credit” are defined as:

a bank’s direct or indirect advance of funds to or on behalf of a borrower based on an obligation of the borrower to repay the funds *or repayable from specific property pledged by or on behalf of the borrower.*³ (Emphasis added).

Here, [] is named the borrower on each of the three promissory notes it has executed with the Bank. Further, the notes are all repayable from the collateral it has pledged to the Bank. Thus, unless an exception to the legal lending limit applies, the Bank’s advances to [] under the three promissory notes are deemed to be loans to [] for the purpose of the lending limit, notwithstanding the non-recourse nature of those notes.

¹ See 12 U.S.C. 84(a); 12 C.F.R. § 32.3(a).

² 12 C.F.R. § 32.2(a).

³ 12 C.F.R. § 32.2(j); see also 12 U.S.C. § 84(b)(1).

However, under 12 C.F.R. § 32.3(c)(10) a loan to a leasing company:

for the purpose of purchasing equipment for lease will be deemed to be a loan to the lessee and not the leasing company, provided that--

- (i) the bank evaluates the creditworthiness of the lessee before the loan is extended to the leasing corporation;
- (ii) the loan is without recourse to the leasing corporation;
- (iii) the bank is given a security interest in the equipment and in the event of default, may proceed directly against the equipment and the lessee for any deficiency resulting from the sale of the equipment;
- (iv) the leasing corporation assigns all of its rights under the lease to the bank;
- (v) the lessee's lease payments are assigned and paid to the bank; and
- (vi) the lease terms are subject to the same limitations that would apply to a national bank acting as a lessor.

The exception at section 32.3(c)(10) incorporated a longstanding OCC interpretive position regarding lease-note financing known as the "U.S. Leasing" exception.⁴ In 1974 the OCC issued an interpretive letter concerning a lease-note financing arrangement proposed by United States Leasing Corporation.⁵ The OCC concluded that in lease-note financing arrangements such as those proposed by U.S. Leasing, the leasing company should be viewed merely as a nominal lessor and servicer of the lease acting on behalf of the lending bank.⁶ Under an arrangement that meets the U.S. Leasing exception, the lessee's rent payments are the primary source of repayment of the loan and are understood to be such by all parties to the transaction. As a result, the lending bank should be able to treat the transaction as the equivalent of a secured loan to the lessee. In the event of default by the lessee, the bank has all the rights of a secured creditor, including the right to demand from the lessee any portion of the rent remaining unpaid after the equipment is sold. In essence, the lender must be placed in the same position as if it had directly leased the

⁴ See 59 Fed. Reg. 6593, Proposed Rule (February 11, 1994); 60 Fed. Reg. 8526, Final Rule (February 15, 1995).

⁵ See OCC Interpretive Letter, December 5, 1974 [1973-1978 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 97,003 ("U.S. Leasing Letter").

⁶ *Id.* See also Letter from Peter Liebesman, Asst. Dir., Legal Advisory Services Division (October 21, 1987) (unpublished) ("Liebesman Letter"); OCC Interpretive Letter No. 287, April 19, 1984 [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,451.

property to the lessee for the U.S. Leasing exception to apply.⁷ The OCC has repeatedly emphasized in its interpretive letters that the U.S. Leasing exception is extremely narrow.

The Bank and [] attempted to structure the loans so as to satisfy the requirements of the exception at 32.3(c)(10). During the recent examination the OCC determined that the Bank's loans to [] met only five of the six enumerated conditions to the exception. The lessees were not making their lease payments to the Bank as required by 12 C.F.R. § 32.3(c)(10)(v).⁸ At issue here is whether the revised manner in which the Bank proposes to collect payments satisfies the condition at 12 C.F.R. §32.3(c)(10)(v).

Under the proposed modification to the loan agreement, all lessees will be directed to make all future payments due on the leases to a lock box at the Bank. The Bank will have sole control over the lock box. On the due date for []'s monthly payment to the Bank under the three notes, the Bank will deduct the amount of the monthly payment owed and apply it to the [] loan. At the end of each month, the Bank will remit any funds remaining in the lockbox to []. This manner of payment satisfies the condition at 12 C.F.R. § 32.2(c)(10)(v) since the lessees will make their payments directly to the Bank. Accordingly, the Bank's loans to [], as modified under the proposal, will satisfy the six conditions of 12 C.F.R. § 32.3(c)(10).

Accordingly, the Bank's loans to [], as modified under the proposal, will satisfy the requirements of 12 C.F.R. § 32.3(c)(10). Consequently, the loans to [] as modified should be treated as loans to each lessee for the purposes of the legal lending limit.⁹

The opinion set forth above is based on the facts and representations included in your correspondence dated December 2, 2002 and December 6, 2002 and our subsequent phone conversations. Any changes to the facts may warrant a different conclusion. Also, please note that this letter responds only to the legal lending limit issue raised in your letter and does not address any safety and soundness aspects of the current loans to [] or the proposed modifications to those loans.

⁷ See OCC Interpretive Letter No. 327, March 15, 1985 [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,497.

⁸ The OCC has opined that lease payments collected by the lessor that are forwarded to the lending bank within one business day of the receipt will satisfy the requirement that the "lessee's lease payments are . . . paid to the bank." Liebesman Letter. In this case, the lessees made their payments to [], and [] remitted the amount owing to the Bank under the loan on a monthly basis. Since [] did not remit the lease payments it received from the lessees to the Bank within one business day, the loans did not meet the condition at 12 C.F.R. § 32.3(c)(10)(v).

⁹ The proceeds of the Bank's loans to [] were used to reimburse it for its purchase of the leased equipment by restoring working capital or repaying the acquisition debt. Thus, the purpose of the Bank's loans to [] was to indirectly finance the purchase of the leased equipment securing the loans. The indirect use of proceeds does not offend the theoretical foundation for the exception that the transactions are the functional equivalent of direct lease transactions between the Bank and the lessees.

If you have any questions regarding this letter, please contact me at (312) 360-8805.

Very truly yours,

Christopher G. Sablich

Christopher G. Sablich
Senior Counsel