



Comptroller of the Currency
Administrator of National Banks

Central District Office
440 S. LaSalle St., Suite 2700
Chicago, IL 60605

Interpretive Letter #925
February 2002
12 USC 84
12 CFR 32

April 12, 2001

Dear []:

I am writing in response to your letter dated March 6, 2001, and supplementary information dated March 9, 2001, requesting our legal opinion. You have asked if loans made by [] ("Bank") to local [] ("local churches") must be combined for purposes of determining the Bank's legal lending limit under 12 U.S.C. § 84. For the reasons set forth below, we believe that the loans to the local churches in question must be combined.

According to the facts set forth in your letter, the Bank has four outstanding loans to four separate local churches, which if combined, would not exceed the Bank's lending limit. The Bank is proposing to lend \$500,000 to a fifth area church, [] (" 5th ") to be used for construction of its new church building, and this proposed loan, if combined with the Bank's existing loans to local churches, may cause the Bank to exceed its lending limit. Each local church is required to enter into a trust agreement with the international office of the parent church, [] ("parent church"), under which the local church is a trustee for all real and personal property, and the parent church is the beneficiary of each trust. The legal title to all property rests in the trustee (local church) until such time as the beneficiary (parent church) directs that it be transferred to itself. The trust agreement states that the trust will be revoked when any member (local church) decides to withdraw from the parent church or takes "action contrary to the polity of the [parent church]," at which time "ownership of all property, both real and personal, remains with the [parent church]."¹

¹ See trust agreement: S44. CHURCH PROPERTY: IV. All Property Owned in Trust for []
(*City, State*).

The general rules for combining loans to separate borrowers are found at 12 C.F.R. § 32.5(a)(1). The regulation states that loans or extensions of credit will be attributed to another borrower when one of two conditions is satisfied:

- (1) When proceeds of a loan or extensions of credit are to be used for the direct benefit of the other person, to the extent of the proceeds so used; or
- (2) When a common enterprise is deemed to exist between the persons.

12 C.F.R. § 32.5(a)(1). A trust is considered to be a "person" for purposes of the rules. *See* 12 C.F.R. § 32.2(k).

Direct Benefit Test

Under the direct benefit test, the proceeds of a loan or extension of credit will be deemed to be used for the direct benefit of another person when those proceeds are transferred to that other person, unless the proceeds are used to acquire property, goods, or services in an arm's length transaction. 12 C.F.R. § 32.5(b). In applying the test to the facts given, it appears that the direct benefit test clearly requires combination of the loans to the local churches.

As noted above, the local church trusts all have an identical beneficiary: the parent church. The trust agreement clearly states that all property is held in trust "for the exclusive use and benefit" of the parent church.² Further, the trust agreements are revocable at the direction of the beneficiary (parent church) for several reasons, including when the local church "shall act contrary to [] polity."³ Upon revocation, the local church "shall convey the said real estate upon demand to the State Board of Trustees of [the parent church] in said state, which said state board shall be authorized to use said real estate and personal property, or the proceeds derived from the sale of same . . . for the use and benefit of the [parent church] in that state generally; or the founding of another [] (*City, State*) in the same state, or for the promotion of one already existing."⁴

In my opinion, the loans to each local church should be attributed to the parent church and combined under the direct benefit test. Those loans should also be combined with any loans which may be extended by the bank to the parent church (we understand that there are currently no loans by the Bank to the parent church). Because the proceeds of loans made to the local churches are used for transactions which are controlled by trusts having an identical beneficiary (the parent church), and this beneficiary is entitled to the ultimate benefit of those transactions, the loans should be combined and attributed to the beneficiary.

² See trust agreement: S44. CHURCH PROPERTY: V. Standard Deeds Recognizing Trust Ownership.

³ *Id.*

⁴ *Id.*

Common Enterprise Test

Under the common enterprise test, found at 12 C.F.R. § 32.5(c), a common enterprise will be presumed to exist and loans to separate borrowers will be aggregated when any of the following conditions are met:

- (1) when the expected source of repayment for each loan is the same and neither borrower has another source of income from which the loan may be fully repaid;
- (2) when the borrowers are related through common control and there exists substantial financial interdependence between those borrowers;
- (3) when separate borrowers borrow to acquire a business enterprise where those borrowers will control more than 50 percent of the voting securities of the business enterprise; or
- (4) the OCC determines that a common enterprise exists based on an evaluation of the facts and circumstances of particular transactions.

For the purposes of this combination rule, control is deemed to exist when a person directly or indirectly, or acting through or together with one or more persons --

- (1) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another person;
- (2) Controls, in any manner, the election of a majority of the directors, trustees, or other persons exercising similar functions of another person; or
- (3) Has the power to exercise a controlling influence over the management or policies of another person.

12 C.F.R. § 32.2(g).

Under the first test, a common enterprise will be deemed to exist when the source of repayment for each loan is the same. 12 C.F.R. § 32.5(c)(1). In this situation, there appears to be no common enterprise because each loan to each local church has a separate source of repayment -- the donations and other revenue generated by each respective church.

Under the second test, a common enterprise will be deemed to exist when the borrowers are related through common control and there exists substantial financial interdependence between them. Substantial financial interdependence is deemed to exist when 50 percent 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, expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments. 12 C.F.R. § 32.5(c)(2)(ii). In this case, the trust agreement explicitly states that the parent church controls the local church trusts, thus satisfying the common control element definition in which one person has the power to exercise a

controlling influence over the management or policies of another person.⁵ However, there does not appear to be substantial financial interdependence, because only five percent of each local church's receipts are sent to the parent church, and the parent church does not routinely fund the expenses of the local churches. Thus, the second common enterprise test is not satisfied.

The third common enterprise test applies when separate borrowers borrow to acquire a single business enterprise. 12 C.F.R. § 32.5(c)(3). This test does not apply in this case, because the loans in question are for purposes other than acquiring a business enterprise.

Even if the above-mentioned *per se* tests for combining loans are not met, the OCC will still require the combination of loans to two or more borrowers when it determines that a common enterprise exists based on the facts and circumstances. 12 C.F.R. § 32.5(c)(4). On its face, subsection (c)(4) appears to grant to the OCC broad, if not unlimited, discretion in combining loans for lending limit purposes even if the three *per se* rules are not met. However, past OCC rulings and interpretations reveal that a very strong evidentiary record based upon a number of factors must exist before a common enterprise will be found to exist solely on the basis of the facts and circumstances. OCC Interpretive Letter No. 563, September 6, 1991, *reprinted in* [1991-1992 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶83,314, at ¶71,439. Indeed, the OCC has stated that instances where the facts and circumstances test will apply to the exclusion of the *per se* rules will be rare. *Id.*; *see also* 54 Fed. Reg. 43,402 (1989).

In various interpretive letters, the OCC has considered the following facts and circumstances to be relevant to a common enterprise determination: engaging in supporting lines of business; interchange of goods and services; common ownership of assets; common management; use of common facilities; commingling of assets and liabilities; closely related business activities; similarity in structure, financing and holding; use of same business address; centralized cash management program; likelihood that a financially troubled member of the group would receive financial aid from other members of the group; family relationships among the borrowers; and pledging of assets to support another's loans. Kenneth C. Rojc, *National Bank Lending Limits - A New Framework*, 40 Bus. Law. 903, 923-24 (1985) (citing various OCC interpretive letters). In my opinion, it may be persuasively argued that many of the above facts and circumstances apply in this case, demonstrating that a common enterprise does exist between the local church borrowers. The local churches engage in supporting lines of business and in closely related business activities, the local churches are commonly controlled by the parent church and have similar, if not identical, structures, and the trust agreement provides for a local church to receive financial assistance from either the parent church or other local churches if necessary.⁶ However, since I believe that the loans in question must be combined under the direct benefit

⁵ See trust agreement: S44. CHURCH PROPERTY: II. Authority of the General Assembly: 1. The General Assembly governs the operation (including ownership of all real and personal property) of the [] (**City, State**) at all structural levels: international, national, state/territorial, district, and local.

⁶ See trust agreement: S43. FINANCIAL SYSTEM: III. Church Reports; B. Accumulated Delinquent Funds.

test, it is not necessary to rely on the facts and circumstances test for determining whether a common enterprise exists.

This analysis is based upon the facts presented and representations made to this Office; different circumstances may affect the legal analysis. Our view of the questions presented by your letter reflects current law and may be subject to revision as future developments warrant. If you have any further questions, please contact me at (312) 360-8805.

We trust this is responsive to your inquiry.

Sincerely,

/s/

Giovanna Cavallo
Senior Attorney