

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians*

Jan Lynn Owen
Commissioner of Business Oversight

August 23, 2016

Re: - Opinion

Dear _____,

Thank you for your letter to the Commissioner of Business Oversight, Jan Lynn Owen, dated August 1, 2016. As counsel for the Legal Division, the Commissioner requested that I respond to this matter. In your letter, you seek an interpretive opinion regarding whether the loans issued pursuant to _____ Bank's new _____ Small Business Loan Program ("Program") must be aggregated for purposes of calculating lending limits pursuant to Financial Code section 1480 et seq. More specifically, you asked whether the loans must be aggregated based on the fact that they have a common servicer.

BACKGROUND

The Bank and _____ have an existing marketing and service agreement regarding a specific portfolio of loans from the Bank to restaurants. Under the terms of that agreement, beyond its duties related to marketing and servicing those loans, _____ has an obligation to purchase any defaulted loans.¹

In your letter, you explained that as a part of the new Program, the Bank now wishes to enter into a new, separate marketing and service agreement with _____ regarding a distinct portfolio of loans, which _____ will not be required to guarantee. With your letter, you provided us a copy of the Marketing and Service Agreement ("Service Agreement"). Additionally, on August 8, 2016, you provided us with a template of the Merchant Agreement ("Loan Agreement") between the borrower and the Bank. This opinion addresses only the applicability of lending limits to the new Service Agreement.

The Service Agreement explains the duties of _____ and the Bank, as well as each of their remedies in the event of a default or breach. It states that _____'s duties will include negotiating with a borrower regarding the terms of the loan; maintaining documentation

¹ The existing agreement between the Bank and _____ in which _____ guarantees the loans and the applicability of lending limits to such loans, was previously addressed in a letter dated December 12, 2005.

related to the loan application and Loan Agreement; and collecting and processing all loan payments from the borrowers, which will be aggregated in a trust account for the benefit of the Bank. You explained in your letter that, unlike the existing agreement, under this new Service Agreement, _____ will not be obligated to purchase the loans.

LENDING LIMIT LAWS

Lending limits serve several purposes. They promote the equal access to banking services, and they protect the safety and soundness of banks. Lending limits prevent banks from lending an excessive amount of money to any one person, or persons who are financially dependent, such as a borrower and his or her guarantor. The Financial Code defines which payments or “obligations” are included in determining whether a bank has exceeded its lending limit.² The law defines “obligations” to include those payments for which a person is primarily or secondarily responsible. It also includes the obligations of others to a bank arising out of loans made by the bank, all for the benefit of the same person.³

Based on the terms of the Service Agreement and the Loan Agreement, it does not appear that _____ will have any responsibility, primarily or otherwise, for making any payments on the loans it services. Unlike the other existing marketing and service agreement, this Service Agreement contains no terms that would hold _____ responsible for purchasing any loans on which a borrower defaulted. In fact, the third recital of the Service Agreement states that _____ “will not be obligated to purchase defaulted _____ Small Business Loans.” Additionally, Section 3.8 of the Service Agreement states that _____ is an independent contractor and that there is nothing in the Service Agreement that will create any other kind of relationship or association between or among _____, the Bank or any borrower. These two clauses indicate that there is no intention to oblige _____ to make any loan payments to the bank based on the arrangement laid out in this Agreement.

Under the terms of the Loan Agreement, only the Bank and borrower are parties to it and _____ is not named as a guarantor, beneficiary, or in any other capacity. Additionally, Section 10 discusses which actions the Bank may take if the borrower defaults on the loan. None of those actions include requiring _____ to make payments on the loan or to purchase any defaulted loans. Further, there is no discussion in the Loan Agreement of any rights, responsibilities, or obligations of _____. Finally, neither the Service Agreement nor the Loan Agreement states that the loan originated by the Bank to the borrower will be made for the benefit of _____.

CONCLUSION

Based on the terms of the new Service Agreement and Loan Agreement, it appears that _____ will have no obligations to the Bank for the Program loans in this new portfolio. The fact that _____ is the common servicer to the Program loans does not create an

² Fin. Code, § 1480 et seq.

³ Fin. Code, § 1480, subd. (b).

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obligation by _____ to the Bank for lending limit purposes. Therefore, the loans made under the Program should not be aggregated for purposes of calculating loan limits.

Please note that this opinion is based solely on the facts presented in your correspondence. Any changes in the facts or circumstances, as we understand them, could lead to a different conclusion.

You may call me at _____ with any questions.

Sincerely,

Jan Lynn Owen
Commissioner of Business Oversight

By

Julie L. Jacob
Counsel

JJ:is

cc: Scott Cameron, Department of Business Oversight, Sacramento
Debie Abella, Department of Business Oversight, San Francisco