

10-1

April 27, 2010

VIA E-MAIL & U.S. MAIL

Re: Opinion Request

Dear _____:

This letter is in response to the various communications with the Department of Financial Institutions ("Department") regarding _____. The three issues are: (1) whether a loan to _____ collateralized by an assignment of the tobacco escrow deposits described in your letter of April 13, 2010, would be considered secured under Financial Code Section 1223; (2) whether it would be permissible for a state-chartered bank to purchase interests in certain tobacco escrow accounts; and (3) whether such interests would be treated as an obligation under Financial Code Section 1221 or a security investment pursuant to Financial Code Section 1330.

Lending Limit

Financial Code Section 1221 limits the unsecured obligations of one person to 15 percent or less of the sum of the shareholders' equity, allowance for loan losses, capital notes, and debentures of the bank. Financial Code Section 1223 provides that an obligation shall not be deemed secured by collateral unless the collateral is of a kind that has not been declared ineligible by the Commissioner and unless it has a market value at least 15 percent greater than the amount of the obligation. Section 10.190202 of the California Code of Regulations sets forth items that are ineligible as security under Financial Code Section 1223, including assigned accounts receivable.

It is our view that the interests in tobacco escrow accounts are similar to assigned accounts receivable, and therefore, they are ineligible as security under Financial Code Section 1223. Further, there is no ready market to determine the market value of the interests. Therefore, the proposed collateral also does not meet the second prong of Section 1223.

In sum, a loan to _____ collateralized by an assignment of the tobacco escrow deposits would not be secured, and the loan would be limited to 15 percent or less of the sum of the shareholders' equity, allowance for loan losses, capital notes, and debentures of the bank.

Permissibility and Limitations of Investment

Financial Code Section 1210 defines “securities issued by a person” as any debt, equity, or other security issued by a person, and any and all affiliates of that person, issued for the benefit of that person or for the benefit of an affiliate of that person. Financial Code Section 1330 limits the total amount invested by a bank in the securities issued by a person to 15 percent of the sum of the shareholders’ equity, allowance for loan losses, capital notes, and debentures of the bank.

A state-chartered bank may invest in the interests in tobacco escrow accounts described in your letter of April 13, 2010. Such interests would be considered “securities issued by a person.” Therefore, pursuant to Section 1330, the investment would be limited to 15 percent of the shareholders’ equity, allowance for loan losses, capital notes, and debentures of the bank.

Limitations of Obligations and Investments

Financial Code Section 1211 would overlay any loan to and investment in _____’s tobacco interests held by a state-chartered bank. Section 1211 limits the total amount of obligations and securities held by a bank to 25 percent or less of the sum of the shareholders’ equity, allowance for loan losses, capital notes, and debentures of the bank. Thus, if a bank were to extend a loan to _____ and invest in _____’s interests in tobacco escrow accounts, the total amount of such loan and securities shall not exceed 25 percent of the sum of the shareholders’ equity, allowance for loan losses, capital notes, and debentures of the bank.

Please be advised that our position is based solely on the representations contained in the various correspondence submitted to the Department. Any change in the facts or circumstances, as we understand them, could lead to a different conclusion.

Very truly yours,

JENNIFER L.W. RUMBERGER
Senior Counsel

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