Charles G. Cooper
Commissioner

TEXAS DEPARTMENT OF BANKING

2601 North Lamar Blvd., Austin, Texas 78705
512-475-1300 /877-276-5554
www.dob.texas.gov

Media Contact:
media@dob.texas.gov

INDUSTRY NOTICE 2023-02
Date: April 25, 2023

Applicability of Texas Legal Lending Limit Statutes to Purchases of Third-Party Loans and Related Supervisory Concerns

Texas state bankers occasionally purchase loans originated by third-parties to diversify their loan portfolios and improve earnings. As a bank's volume in third-party loans purchased from any one originator/seller approaches 25% of the bank's Tier 1 capital, bank management should be aware of the factors and considerations discussed below to prevent violating the bank's legal lending limit.

Third-party loans can be aggregated and attributed to the seller under Texas law if they are purchased with recourse or otherwise guaranteed by the seller, and if the purchasing bank is not relying primarily on the creditworthiness of the primary obligor/borrower, as stated in Title 7, Texas Administrative Code §12.9(g). Aggregation of third-party loans and attribution to the seller for lending limit purposes is not limited to situations where the bank has an express guaranty or other contractual recourse against the seller. Even if the seller only provides implied or limited recourse to the bank, a lending limit violation may arise from that bank's failure to properly manage third-party lending programs.

Implied recourse can be demonstrated by a bank's practices. For example, if a seller provides loan substitutions, loan payoffs, or a reserve account used for replacement payments to the bank, that recourse could indicate an informal agreement or course of dealing between the seller and the bank demonstrating the bank's reliance on the seller for repayment and providing a basis for aggregation. In this situation, if the total amount of loans acquired from that seller exceeds the bank's legal lending limit, the bank would have violated the legal lending limit because the bank relies on the seller for repayment, resulting in aggregation of all loans acquired from that seller and attribution of those aggregated loans to that seller.[1]

As it pertains to a bank's legal lending limit and sound risk management practices, implementation of a third-party lending program should validate that bank management is indeed relying on the

[1] *See, e.g.,* Department Legal Opinion 94-75 (finding that third-party receivables purchased from a seller should be aggregated and attributed to the seller for legal lending limit purposes because the bank did not collect receivables upon default and instead exercised repurchase option to recover full balance of defaulted receivables from the seller's reserve account with the bank).

borrower to service the loan and not the seller of the loan. A loan program that reflects the bank's reliance on the borrower for repayment and not the seller would incorporate the following factors:

- Preparing and maintaining adequate documentation of pre-purchase and ongoing credit analysis of the borrower's repayment ability that demonstrates reliance on the maker;
- Documenting reliance on the borrower for full repayment and not the seller;
- Establishing loan policy guidelines for the acquisition of third-party acquired loans which should be comparable to similar loans made by the bank, including factors such as borrower creditworthiness, interest rates, and collateral;
- Receiving interest rates that reflect the credit risk of the purchased loan and not the perceived strength of the seller;
- Adequately documenting bank board and/or loan committee minute discussions;
- Identifying and tracking payment history, including past due status and loan payments made by the borrower, and
- Receiving loan payments directly from the borrower and crediting such payments to the specific loan in question, and not receiving into or crediting a commingled account.[2]

In the alternative, banks that do not rely on the borrowers of the purchased notes, and instead rely on the seller, should obtain an express, appropriately broad contractual guaranty from the seller, and conduct adequate initial and ongoing diligence on their credit relationship with the seller.

As the Department has previously cautioned, banks should "heed the underlying purpose of the legal lending limit" relating to basic safety and soundness:

> While a bank may be empowered to make loans that collectively aggregate more than the bank's legal lending limit, the bank in question must have the ability, capacity, and commitment to appropriately evaluate and manage the risks inherent in such lending activities. Thus, these types of loans will be closely scrutinized by an examiner to monitor the bank's adherence to its policies and procedures and to ensure that the bank is administering such loans in a manner that is consistent with safe and sound banking practices.[3]

Questions regarding this notice should be directed to the Bank and Trust Division via email or (512) 475-1322.

---

[2] *See, e.g.,* Department Legal Opinion 02-03 (noting that the Department expects loan files to contain written documentation demonstrating reasonable reliance on the primary borrower, and that the bank in question "must have the ability, capacity, and commitment to appropriately evaluate and manage the risks inherent in such lending activities"); Department Legal Opinions 97-02 ("Unless each loan file is fully documented to reflect that the expected source of repayment is not the same, the loans will be aggregated."); Department Legal Opinion 95-26 (holding that, to avoid aggregation, "each loan file should be properly documented to reflect the creditworthiness of the individual borrower and the basis for the bank's reasonable reliance on the individual borrower as the source of repayment").

[3] *See, e.g.,* Department Legal Opinion 02-03.