



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

AUDIT REFERRAL # 06-01

January 25, 2006

**MEMORANDUM**

TO: Thomasenia P. Duncan  
Associate General Counsel

THROUGH: Robert J. Costa *RC*  
Acting Staff Director

FROM: Joseph F. Stoltz *JFS*  
Assistant Staff Director  
Audit Division

Tom Nurthen *TN*  
Audit Manager

Nicole Burgess *NB*  
Lead Auditor

SUBJECT: Democrat, Republican, Independent Voter Education Political Campaign  
Committee (A03-49) – Referral Matter

On July 5, 2005, the Commission approved the final audit report on the Democrat, Republican, Independent Voter Education Political Campaign Committee. The final audit report was released to the public on July 18, 2005, and included the following issue which meets the criteria for referral to your office: Apparent Prohibited Contributions – Bank Loans.

All workpapers and related documentation are available for review in the Audit Division. Should you have any questions regarding this matter, please contact Nicole Burgess or Tom Nurthen at 694-1200.

Attachment:

- FAR Finding (Apparent Prohibited Contributions – Bank Loans)

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## **Finding 1. Apparent Prohibited Contributions – Bank Loans**

### **Summary**

DRIVE reported receiving two loans totaling \$500,000 from Amalgamated Bank (the Bank). Each loan was reported on Schedule C. Schedule C-1 indicated that each loan was secured and described the collateral as accounts receivable. However, it does not appear that either loan is secured. The Audit staff recommended that DRIVE demonstrate that the loans were secured; made in the ordinary course of business; and, not a prohibited contribution or file amended reports disclosing each loan as unsecured. However, DRIVE did neither.

### **Legal Standard**

**Loans Excluded from the Definition of Contribution.** A loan of money to a political committee by a State bank, a federally chartered depository institution (including national bank) or a depository institution whose deposits and accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration is not a contribution by the lending institution if such loan is made in accordance with applicable banking laws and regulations and is made in the ordinary course of business.

A loan will be deemed to be made in the ordinary course of business if it bears the usual and customary interest rate of the lending institution for the category of loan involved; is made on a basis which assures repayment; is evidenced by a written instrument and is subject to a due date or amortization schedule. 11 CFR §100.7(b)(11)

**Assurance of Repayment.** Commission regulations state a loan is considered made on a basis which assures repayment if the lending institution making the loan has:

- Perfected a security interest in collateral owned by the political committee receiving the loan.
- Obtained a written agreement whereby the political committee receiving the loan has pledged future receipts, such as public financing payments.
- If these requirements are not met, the Commission will consider the totality of circumstances on a case by case basis in determining whether the loan was made on a basis which assured repayment. 11 CFR §100.7(b)(11)(i) (A) and (B)

When pledged future receipts are used to assure repayment by a committee that does not receive Presidential Matching Funds, the relevant requirements are that:

- The amount of the loan does not exceed the pledged funds.
- Loan amounts are based on reasonable expectations that the pledged funds will be received. The committee must furnish the lending institution documentation such as cash flow charts or other financial plans that reasonably establish that such funds will be available.
- A separate account is established at the lending institution, or the lender is given an assignment that permits the lender access to an account at another institution, and the

pledged funds are required to be deposited into the separate account for the purpose of retiring the debt. 11 CFR §100.7(b)(11)(i)(B)

### **Facts and Analysis**

DRIVE received two loans from the Amalgamated Bank. The first loan in the amount of \$300,000 was received on October 29, 2002. The second loan in the amount of \$200,000 was received on November 1, 2002. DRIVE reported each loan on Schedules C (Loan Information) and C-1 (Loans and Lines of Credit). Schedule C-1 indicated that the \$300,000 loan was secured by future receipts described as Accounts Receivable and the \$200,000 was reportedly collateralized by Accounts Receivable and Certificates of Deposit.

Each loan was supported by a revolving promissory note, continuing security agreement, and a covenant agreement. These documents were signed by DRIVE's Chairman and Treasurer.<sup>1</sup> The revolving promissory note listed collateral as accounts receivable, bank deposits, certificates of deposit, and general intangibles. The covenant agreement required DRIVE to provide the Bank with a reasonable estimate of revenue for a six month period, unaudited quarterly financial statements, a year end balance sheet, and a statement of income and retained earnings.

Although the loan documents appear to demonstrate that each loan was secured, in fact, neither loan was secured by collateral. For example, DRIVE did not maintain any certificates of deposit and even though DRIVE maintained its checking accounts at the Bank, it appears that there were no holds or restrictions on the use of funds from these accounts. There were no documented outstanding accounts receivable and neither Bank document described the make up of "general intangibles." Further, there was no evidence made available that DRIVE provided the Bank with any of the financial statements or revenue estimates required by the covenant agreement; nor was there any evidence that the Bank made any attempts to obtain such information. Therefore, the Audit staff concluded that the loans were not made on a basis that assures repayment.

Finally, it should be noted that DRIVE did not properly disclose the loans as outstanding on its Year-End 2002 disclosure report. Each loan was paid off in calendar year 2003. It was not until 2005 that DRIVE amended its 2003 reports to show the loans as outstanding until paid and to show the payments.

This matter was discussed during fieldwork and at the exit conference. The DRIVE representative acknowledged that the collateral did not exist, with the exception of bank deposits, which were not restricted. He further indicated that the Bank is a "labor bank" that is privately owned and is willing to extend credit to unions and their political action committees.

### **Interim Audit Report Recommendation**

The Audit staff recommended that DRIVE provide evidence demonstrating that the loans were secured; were made in the ordinary course of business; and, why each loan should

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<sup>1</sup> Our copies of the documents are not signed by a bank representative.

not be considered a prohibited contribution from the bank. Absent such a demonstration, DRIVE should have filed amended reports to correctly disclose each loan as unsecured.

### **Committee's Response to Recommendations and the Audit Staff's Assessment**

In response, DRIVE representatives stated:

“the loans were made in accordance with applicable banking laws and regulation, under the ordinary course of business, and on a basis which assures repayment meaning that: 1) Prior to approving the loan, DRIVE provided Amalgamated Bank with financial documents demonstrating the amount of future membership contributions on a monthly basis and that the contributions would be available as security for the loans. After reviewing these documents, DRIVE's credit history as well as other standard loan criteria, Amalgamated Bank made the loan at the usual and customary interest rate for the category of loan involved and in a manner fully compliant with federal regulations. 2) As required by federal regulations, Amalgamated Bank required repayment of the loans. Amalgamated Bank was assured that it would be repaid through a written instrument. And, these loans were secured by DRIVE's monthly membership contributions which were deposited in a savings account with Amalgamated Bank. This account served as collateral for the loans which is typical of the type of collateral offered by political committees. **In addition, it is important to note that the total loan amount did not exceed the amount of pledged funds and in fact, the amount of money in DRIVE's account at Amalgamated Bank always exceeded the amount of the loans (emphasis added).**”

DRIVE also provided a copy of a “Deposit Account Pledge Agreement” applicable to DRIVE's money market account which held the pledged deposits. According to the agreement under section 2 (b) Blocked Account, “so long as any of the Liabilities shall remain unpaid: (i) the Deposit shall be kept in a separate blocked Account or Accounts or, if the Deposit is a portion of a Account, the pledged portion of the Account shall be blocked and held in that account.” Deposit is defined as funds in the Account.

According to a letter from the Bank, DRIVE's accounts receivable, general intangibles and cash secured both loans. The Bank also maintains that DRIVE's account balance always exceeded the outstanding loan balance and the cash on deposit was sufficient to act as full collateral for the loan.

Both DRIVE and the Bank asserted that the total loan amount did not exceed the amount of pledged funds and in fact, the amount of money in DRIVE's account at Amalgamated Bank always exceeded the amount of the loans. However, the bank statements indicate that the balance fell below the \$500,000 loan principal on November 18, 2002,

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(\$495,228) and remained under that amount through December 4, 2002 (\$399,593)<sup>2</sup>. It is therefore clear that any block that may have been attached to the account was not equal to the loan amount.

DRIVE also states that revenue projections were provided to the Bank prior to obtaining the loan to provide assurance of repayment. As noted in the Legal Standards above, if future receipts are used to provide assurance of repayment for a loan, specific requirements must be met. The documentation provided to date fails to demonstrate that those requirements have been met.

It is the opinion of the Audit staff that DRIVE has not demonstrated that the loans were made on a basis that assures repayment and not contributions by the Bank.

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<sup>2</sup> In addition, there were significant amounts of outstanding checks that had been written on the DRIVE's zero balance operating account which was funded by the same money market account that holds the pledged deposits. Those amounts are not reflected in the bank statement balances. Thus how far below the loan principal amount the account balance went was, in part, dependent on how quickly payees negotiated their checks. For example, as of October 31, 2002, the zero balance operating account had \$644,489 in outstanding checks while the money market account had a balance of \$811,672 (loan balance was \$300,000).