Purchased Loan Participations

Directors College Material

Division of Risk Management Supervision
Background

• Loan participation: sale or sharing of ownership between two or more institutions

• Lead bank administers the loan for the benefit of all participants

• Participation agreement defines roles and responsibilities of lead bank and participant(s)
Participation Agreement

• Basic Elements Should Include:
  – Parties involved
  – Total loan amount and amount purchased
  – Loan maturity date
  – Recourse provisions
  – Order of payment (pro rata, first-in, etc)
  – Collateral position
  – Rights and remedies for a breach of contract
  – Servicing responsibilities
  – Basis of revenue and expense distribution
  – Loan documentation responsibilities
Participation Agreement (continued)

Other considerations:

- Timeliness of information sharing
- Consultation with participants prior to pursuing action on defaulted loans
- Resolution procedures to address disagreements between participants
- Termination provisions
Independent Credit Decision

• Prior to purchase, banks should obtain and analyze:
  – Loan closing documents
  – Borrower financial statements and appraisals
  – Any other information needed to make the loan decision

• Loan policy guidance
Ongoing Monitoring

• Documentation updates
  – Borrower and guarantor financial information
  – Collateral information
  – Credit memorandum

• Lead bank condition
Risks

- Over-reliance on selling institution
- Loss of flexibility
- Inability to obtain timely information
- Loss exposure under workout or liquidation
- Directed purchase from affiliate
- Over-reliance on recourse provisions
- Out-of-territory
Resources

• Risk Management Manual of Examination Policies, Section 3.2, Loans

• Guidance for Third-Party Risk, FIL-44-2008

• Correspondent Concentration Risks Interagency Guidance, FIL-18-2010