Federal Deposit Insurance Corporation
Division of Resolutions and Receiverships
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Risk Sharing Asset Management
Guidance RSAM-2011-15

To: **Assuming Institutions under Shared-Loss Agreements**

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Subject: **FDIC Commercial Loss Mitigation Guidance for Loan Participations**

Summary:

The FDIC is providing this guidance to Assuming Institutions (AIs) regarding the administration of Shared-Loss Loans under the terms of the Commercial Shared-Loss Agreement ("CSLA") that are not wholly owned by the AI such as Syndicated Loans, Shared National Credits and Loan Participations ("Participations").

Highlights:

- **Loan Participation Evaluation**
- **Potential CSLA Conflicts**
- **Permitted Loan Modification Alternatives**

Contact: Assuming Institutions should contact their Loss Share Specialist with any questions regarding this Guidance.

The attached information is provided for general guidance and clarity on the matters contained therein. The attached information is not intended to modify, or otherwise supplant, any provisions or definitions contained with the applicable Shared-Loss Agreements. The Assuming Institution is strongly encouraged to seek appropriate legal counsel for a comprehensive analysis and understanding of the matters contained within Shared-Loss Agreements.

FDIC Commercial Loss Mitigation Guidance
Loan Participations

Objective

The FDIC is providing this guidance to Assuming Institutions (AIs) regarding the administration of Shared-Loss Loans under the terms of the Commercial Shared-Loss Agreement ("CSLA") that are not wholly owned by the AI such as Syndicated Loans, Shared National Credits and Loan Participations ("Participations"). These Shared-Loss Loans are governed by Participation/Credit Agreements with other participating financial institutions. This guidance is intended to clarify the treatment of Participations under CSLA and discuss management strategies that may be in conflict with the provisions of the CSLA. ***This guidance is for informational purposes only as the AI considers management strategies for Participations.***

The capitalized terms used in this guidance have the meaning set forth below or as they are separately defined in the CLSA.

Loan Participation: a sharing or selling of ownership interests in a loan between two or more financial institutions. Normally, but not always, a lead bank originates the loan and sells ownership interests to one or more participating banks. The lead bank retains a partial interest in the loan, and holds all loan documentation in its name, holds all original documentation, services the loan and deals directly with the Borrower for the benefit of all participants. Participations can either be made on a pari passu basis with equal risk sharing for all loan participants, or on a senior/subordinated basis, where the senior lender is paid first and the subordinate loan participation is paid only if there is sufficient funds left over to make the payments. Such senior/subordinated loan participations can be structured either on a LIFO (Last In First Out) or FIFO (First In First Out) basis. Participation Agreements are generally scrutinized as part of safety and soundness examinations. Examiners look for terms and conditions that provide for sharing of information about the borrower and the credit during the entire life of the loan and participation. It is also important to understand the lead bank's administrative responsibilities, especially in the face of disagreement about how to handle the borrower's default.

Syndicated Loans: a loan made respectively by two or more lenders contracting directly with a borrower under the same credit agreement. Each lender has a direct legal relationship with the borrower and receives its own promissory note(s) from the borrower. Typically one or more lenders will also take on the separate role of agent for the credit facility and assume responsibility of administering the loans for the lenders. A syndicated loan differs from loan participation in that the lenders in syndication participate jointly in the origination and the lending process.

Shared National Credit (SNC): any loan and/or formal loan commitment extended to a borrower by a supervised institution (subject to supervision by one of the federal banking agencies (FBA)), its subsidiaries, and affiliates that totals $20 million or more and (1) is shared by three or more insured institutions under a formal lending agreement or (2) a portion of which is sold to two or more insured institutions, with the purchasing institutions assuming a pro rata share of the credit risk. An agent originates a SNC and administers it for the other lenders.

Participation Agreement: a legal agreement (which may also be referred to as a Credit Agreement) between financial institutions or lenders sharing in the financing of a loan. The Participation Agreement will include the terms of the arrangement to include profit sharing among the lenders, loan fee sharing, standard of care the lead lender or administrator owes to the participants, and the responsibilities of the participants.

Loan Participation Evaluation ("Evaluation")

A review of the Shared-Loss Loan portfolio should be conducted by the AI to identify Participations under CSLA as soon as possible with priority given to Shared-Loss Loans when imminent monetary default is probable (i.e. maturing loan; inadequate cash flow). The AI's Evaluation should include a comprehensive legal review of the Participation Agreement and all related loan documents to determine the AI's rights, responsibilities, recourse and risks and to identify potential conflicts with the terms of the CSLA.

Participations that have identifiable or potential CSLA conflicts should be discussed immediately with the FDIC, to determine future loss share eligibility. Some examples of CSLA conflicts are (1) a non-legally binding advance of funds that exceeds 110% of the Book Value of the Shared-Loss Loan after the advance has been made; and (2) the extension of the loan term beyond the end of the final Shared-Loss Quarter. Participation conflicts or variances from the terms of the CSLA should be analyzed by the AI and, if necessary, submitted to the FDIC for approval of a blanket or one-off exception to protect the shared-loss coverage on the Participations. The CSLA exception request should:

1. Minimize the loss to the FDIC and the AI on the Participation.
2. Be consistent with the AI's treatment of non Shared-Loss Participations.
3. Be consistent with usual and prudent business and banking practices.

The Evaluation should be documented and retained by the AI for purposes of the FDIC's monitoring and oversight of shared loss assets under the CSLA.

Loan Modifications

Early and frequent communication by the AI with the lead participant is encouraged to ensure compliance with the CSLA and Participation Agreement. When presented with loan modification strategies by participating financial institutions, the AI should review the CSLA to determine if the strategy is authorized under the CSLA. Management strategies that are in conflict with activities allowed under the definition of Permitted Amendment under the CSLA, or are not specifically addressed in the CSLA should be discussed with the FDIC. The AI's credit analysis for Shared-Loss Participations should be consistent with the AI's current underwriting practices for non-participated Shared-Loss Loans. This review should include a comprehensive evaluation of the borrower's willingness and capacity to repay, borrower guarantees, the borrower's business plan, the debt coverage of the collateral, and the value of the underlying collateral. Potential conflicts with the terms of the CSLA should be analyzed and considered by the AI and submitted to the FDIC for a one-off exception approval, if the analysis indicates that it will minimize the loss to the FDIC and the AI on that Participation. Loan modification alternatives may include, but are not limited to the following:

A. Permitted Amendments

Participation modifications must be consistent with the terms of Permitted Amendments as defined in the CSLA in order to be eligible for shared-loss coverage under the CSLA. A loan modification (governed by the definition of Permitted Amendment under the CSLA) is designed to convert a non-performing loan, or a loan that is on the verge of being nonperforming, to performing status consistent with the ability of the borrower to repay the debt. Acceptable loan modifications can reduce the loan payment for a period of two to four years and may permanently alter some conditions of the loan, including extension of the term of the loan, interest rate reduction, and principal forbearance which may be adjusted in any sequence. An amendment extending the term of Participation beyond the end of the final Shared-Loss Quarter is not a Permitted Amendment as the term is defined in the CSLA, and any such amendment **will extinguish** the shared-loss coverage on the amended Shared-Loss Loan.

B. Permitted Advances

Participation advances that are not authorized under the Participation Agreement must be consistent with the terms of Permitted Advances as defined in the CSLA in order to be eligible for shared-loss coverage under the CSLA. A loan advance (governed by the definition of Permitted Advance under the CSLA) should be made in good faith and be supported at the time it is made by documentation in the credit files. It must conform to and be in accordance with the applicable requirements set forth in Article III of the CSLA and with the then effective written internal credit policy guidelines of the AI.

C. Participation Sales

The AI is free to sell Participations but if it does so without the prior approval of the FDIC it will lose loss coverage on the entire Shared-Loss Loan, i.e. it will not be allowed to submit a loss claim under the CSLA for any loss on the unapproved sale. In addition, unapproved sales of Participations under CSLA will receive additional scrutiny during the FDIC's monitoring and oversight process. The FDIC may reverse any Charge-Off previously taken on such Participation in anticipation of the unapproved sale. For the avoidance of doubt, Short Sales and Discounted Pay-Offs are not considered loan sales under the CSLA. Short Sales and Discounted Pay-Offs must be supported by credit file documentation and are subject to compliance review by the FDIC for commercially reasonable transaction standards.

D. Participations with the FDIC

Participations that are participated with (1) the FDIC as the Receiver of a Failed Institution, (2) another AI(s), or (3) a FDIC Structured Transaction should be treated the same as non-Receiver related Participations.

Following is a summary of key loan participation and loan syndication provisions. The AI is responsible for performing an Evaluation to determine the governing provisions for its Participations under CSLA.

Issue or Provision	***Participation***	***Syndication (Agented/Multi-Lender Credit Facility)***
Nature of property interest	Participant is not a direct creditor of the borrower. Generally, structured as a sale of undivided interest in the rights of the originator.	Each lender is a direct creditor of the borrower.
Recover of taxes & funding losses; gross up for reserves	Loan documents generally do not permit the participant to recover taxes, funding losses, gross up for reserve requirements and similar capital guidelines based on its actual exposure. Originator may have the right to collect these amounts, but its exposure may not be the same as the participant.	Loan documents generally provide that each lender can recover taxes, funding losses, gross up for reserve requirements and similar capital guidelines based on its actual exposure.
Common law rights	There is no debtor-creditor relationship between the participant and the borrower, therefore the participant does not have common law rights of setoff. However, loan documents may provide for specific rights of the participants.	Each lender has a traditional debtor-creditor relationship with the borrower.
Insolvency of originator/agent	Depending on the participation agreement, participant rights may be impaired in an insolvency of the originator. If the originator is a regulated entity (insured bank, insurance company, etc) and has not complied with statutory or regulatory requirements as to documentation for the participation, the Receiver of the insolvent originator may have defenses to enforce the Participation Agreement.	Insolvency of the administrative agent should not affect the interest of each lender with respect to obligations of the borrower to the lender.
Legal opinions	Participant may not be able to rely on legal opinion (of borrower's counsel) if the opinion either is not addressed to participant or does not state that participant can rely on it.	Generally, the opinion is for the express benefit of all lenders (in addition to the agent) and all lenders can rely on legal opinions.

Issue or Provision	*Participation*	*Syndication (Agented/Multi-Lender Credit Facility)*
Assignments	Generally, participant cannot assign, sub-participate or encumber its interest.	Subject to any eligible assignee requirements, lender's interest is generally assignable and can be participated and encumbered.
Enforcement actions	Generally, participant has no right to cause the originator to enforce remedies (although this can be addressed in the participation/servicing agreement).	Generally, lender (either alone or with other "required lenders") can cause agent to enforce remedies; subject, of course, to limitations of the documents.
Amendment (workout) rights	Most participation agreements allow participant to only prevent amendments that affect certain "sacred rights," such as interest rate and payment dates.	Generally, lender (either alone or with other "required lenders") can cause or prevent amendments to any provision of loan documents.
Waiver rights	Most participation agreements allow participant to only prevent waiver of material rights, such as payment defaults.	Generally, lender (either alone or with other "required lenders") consent is required for any waiver.
REO decisions	Many participation agreements are silent on participant rights relating to REO decisions. The participation agreement needs to be closely reviewed for this issue.	Generally, the agent has authority (under the co-lender provisions) to manage, lease & complete REO; however, "major" decisions (such as large leases and sales) typically require the consent of the "required lenders."