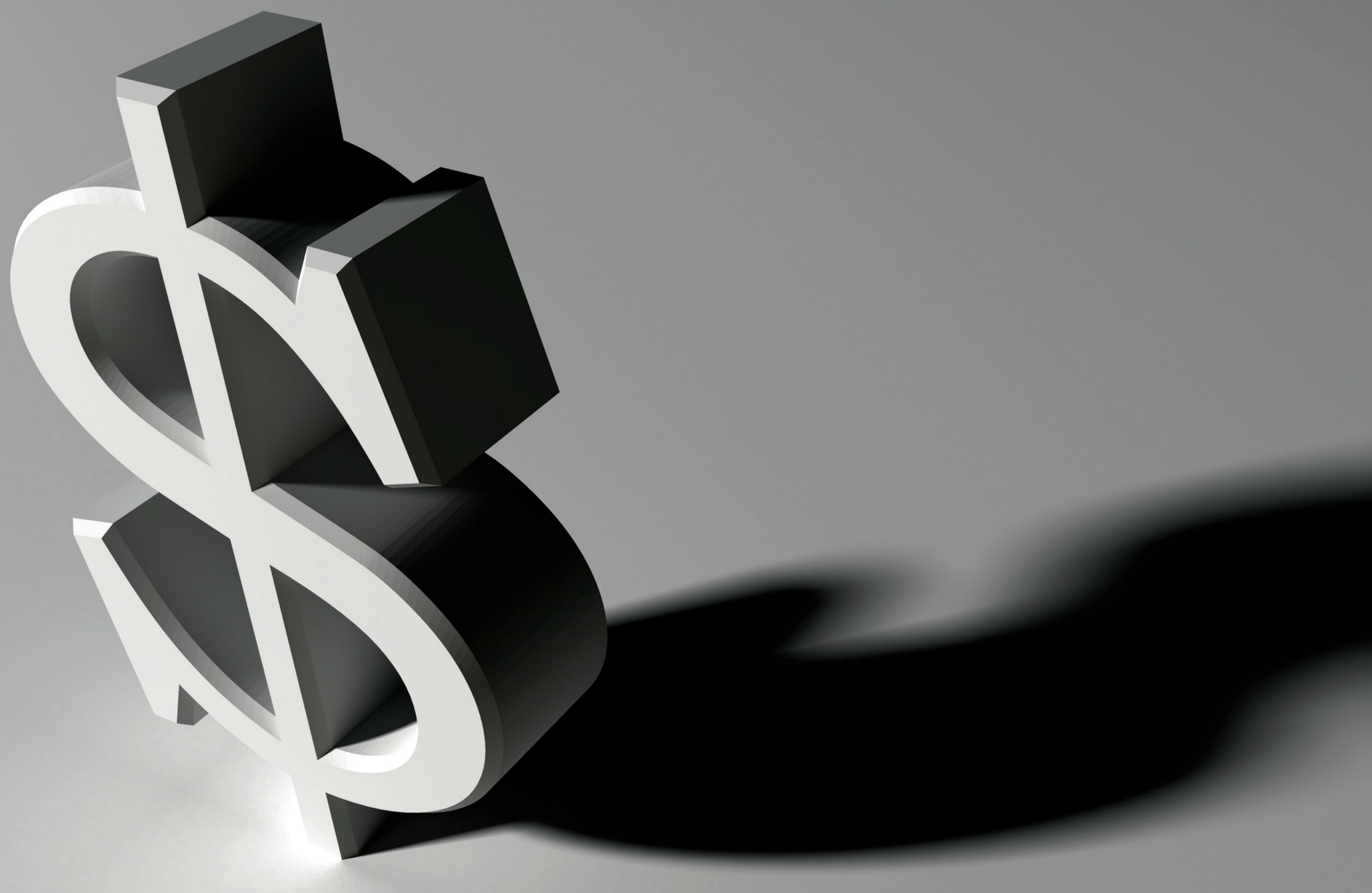
IDENTIFYING OPPORTUNITIES FOR COMMUNITY BANKS THROUGH SYNDICATED LOANS AND LOAN PARTICIPATIONS



By: Lyle Washowich, Esq.
and Alexandra Malatesta
Burns White LLC

In the aftermath of the Great Recession, community banks have struggled to find ways to regain lost revenue in the face of fewer traditional loan opportunities. However, in the wake of such challenges, investment banks and other financial institutions have been more frequently looking to community banks to diversify these larger institutions' investment portfolios and diffuse the risk of extraordinarily large loans.[1] In kind, by investing in syndicated loans or purchasing loan participations, community banks can find ways to grow revenue by expanding beyond (a) traditional deposits, (b) real estate-related loans, or (c) fixed-income securities laden with interest rate risk and low returns.[2] In addition, in many instances, syndicated loans and loan participations allow access to industries normally precluded by regulated capital requirements or the local economy of a bank's immediate community.[3]

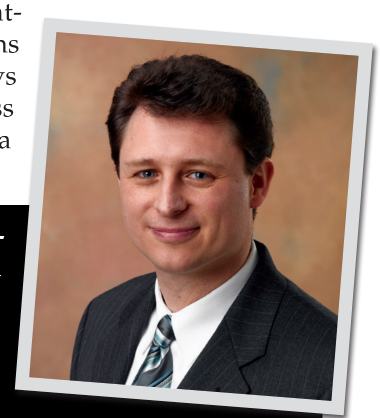
Though commonly confused, loan syndication and loan participation are separate and distinct methods of facilitating a loan to a single borrower. A syndicated loan is made by two or more lenders who contract directly with a borrower under the same credit agreement.[4] Under this type of loan, each lender possesses a direct legal relationship with the borrower, with each lender receiving its own promissory note from the borrower.[5] Hence, if the lead bank (often the leading lender) becomes insolvent, the obligations between the borrower and other syndicate banks will be unaffected.[6] The decision to underwrite this type of loan evidences confidence in the stability of the borrower and the quality of the investment.

A loan participation, on the other hand, involves the sale of portions of a loan. After issuing the loan, the lead bank retains an interest in the loan but subsequently sells portions of its ownership to other banks.[7] Such sales are memorialized in a "Participation Agreement" that creates a contract between the lead bank and the purchasing "participant" bank that is independent from the contract between the lead bank and the borrower.[8] In exchange for an economic interest in the loan, participant banks become creditors of the lead bank (and not creditors of the borrower).[9] Paperwork is maintained by the lead bank – which deals directly with the borrower on behalf of the other participants.[10]

Both syndication and loan participation are dependent upon the comprehensiveness of the disclosures made by the lead bank and the syndicates' or participants' comfort with the structure of the original loan. While the amount of information exchanged between the lead bank and the prospective syndicates/participants can vary in terms of depth and complexity, the lead bank provides an information memorandum that describes the nature of the loan and the stability of the borrower.[11] This memorandum can include, among other things, information about the borrower's business, financial models, investment considerations, terms and conditions or, in the case of more complex arrangements, extensive discussion of due diligence and financial projections.[12] Syndicates and participants rely on the loan documentation provided by the lead bank in order to conduct an independent credit evaluation of the borrower.[13] Hence, transparency is crucial not only for the lead bank's adherence to its fiduciary duty, but also to allow community banks to answer the essential question: is this the type of loan we would make ourselves?

Prudent negotiation of Loan Syndication or Participation Agreements requires consideration of the extent of a community bank's oversight and management influence over the leading bank's portfolio.[14] In-market participations and strategic syndicates/participants consisting of local competitors can serve to lessen the risk assumed by the community bank when entering into a syndication or loan participation.[15] And, regulatory oversight encourages banks to minimize risk by confining loans to local, familiar markets.[16] Depending upon the size of the bank's investment, community banks should also consider independent collateral review and/or meeting with the potential borrower.[17]

Loan Syndication and Participation Agreements allow community banks to grow revenue and expand beyond single borrower/bank relationships. With the "loan-to-deposit ratio of the banking system as a whole...as low as it has been in 20 years," syndicated loans and loan participations are potentially lucrative ways for community banks to "access loans and higher yields" in a safe and efficient way.[18]



Lyle D. Washowich is Co-Chair of the Banking and Financial Services Litigation Practice Group at Burns White LLC. With experience handling disputes in state/federal courts and private venues, he has represented national banks, federal and state savings associations, state-chartered banks, community banks and other affiliated entities in alleged breaches of contract, disputes among partnerships and other business interests, alleged breaches of fiduciary duties, alleged conspiracy claims, claims involving the Uniform Commercial Code (UCC), and other types of statutory and common law claims. Alexandra Malatesta is a law clerk at Burns White LLC, where she provides research and writing support to the firm's practice areas.

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