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	A	B	C	D	E	F
38		Interest Rate Risk Assessment	Yes/No/NA			Comments
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42	3.1.2	(b) The possibility the maturity date will be extended?				
43	3.1.3	(c) "What-IF" scenarios to assess IRR impact of the maximum or planned purchase?				
44		Liquidity Risk Assessment	Yes/No/NA			Comments
45	4.0.0	If the credit union has completed an initial risk assessment, does it include a liquidity risk assessment?				
46	4.1.0	Has management evaluated:				
47	4.1.1	(a) Adequacy of reporting systems for interest accrual, payment status, and balances?				
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49		Transaction Risk Assessment	Yes/No/NA			Comments
50	5.0.0	If the credit union has completed an initial risk assessment, does it include a transaction risk assessment?				
51	5.1.0	Has management evaluated:				
52	5.1.1	(a) How cash will flow between the counterparties and the borrowers?				
53	5.1.2	(b) Are loan systems set up to account for all loan types being participated?				
54	5.1.3	(c) How to assure the transaction meets the definition of true sale accounting?				
55	5.1.4	(d) How environmental risk will be identified and mitigated?				
56	5.1.5	(e) Is bond coverage sufficient for expanded activities?				
57		Compliance Risk Assessment	Yes/No/NA			Comments
58	6.0.0	If the credit union has completed an initial risk assessment, does it include a compliance risk assessment?				
59	6.1.0	Has management evaluated:				
60	6.1.1	(a) Are selling credit union's systems and controls adequate to detect compliance errors and omissions and complete corrective action?				
61	6.1.2	(b) Authority and accountability for compliance?				
62	6.1.3	(c) Borrower qualifies as a member?				
63	6.1.4	(d) Are the selling and buying credit unions subject to different regulations?				
64	6.1.5	(e) Will loan documents be acceptable according to state laws to which each credit union is subject?				
65	6.1.6	Does the selling credit union's appraisal program comply with regulations and guidance?				
66		Strategic Risk Assessment	Yes/No/NA			Comments
67	7.0.0	If the credit union has completed an initial risk assessment, does it include a strategic risk assessment?				
68	7.1.0	If yes, does it address:				
69	7.1.1	(a) Are information systems adequate?				
70	7.1.2	(b) Is there an exit strategy?				

	A	B	C	D	E	F
71		Reputation Risk Assessment	Yes/No/NA		Comments	
72	8.0.0	If the credit union has completed an initial risk assessment, does it include a reputation risk assessment?				
73	8.1.0	Has management evaluated:				
74	8.1.1	(a) Third party independence?				
75	8.1.2	(b) Full disclosure?				
76	8.1.3	(c) Management's understanding of the transaction?				
77	8.1.4	(d) Adequacy of internal controls?				
78	8.1.5	(e) Quality of the knowledge of the person performing the assessment?				
79		Due Diligence for Loan Participations	Yes/No/NA		Comments	
80	9.0.0	Did the credit union perform due diligence on the loan participation program and prospective participation partners?				
81	9.1.0	Has management evaluated:				
82	9.1.1	(a) Business model?				
83	9.1.2	(b) Cash flows?				
84	9.1.3	(c) Financial and operational control review?				
85	9.1.4	(d) Contract issues and legal review?				
86	9.1.5	(e) Loan underwriting?				
87	9.1.6	(f) Quality control process?				
88	9.1.7	Are report and monitoring practices adequate to manage the ongoing portfolio risks?				
89		Loan Participation Policies	Yes/No/NA		Comments	
90	10.0.0	Does the credit union have a loan participation policy?				
91	10.1.0	Has management addressed:				
92	10.1.1	(a) Underwriting standards?				
93	10.1.2	(b) Legal review requirements?				
94	10.1.3	(c) Loan monitoring and evaluation practices?				
95	10.1.4	(d) Loan servicing?				
96	10.1.5	(e) Periodic review?				
97	10.1.6	Is the credit union in compliance with the above requirements?				
98		Loan Participation Agreements	Yes/No/NA		Comments	
99	11.0.0	Does the credit union have a copy of the loan participation agreement?				
100	11.0.1	Is the participation agreement signed by all parties?				
101	11.1.0	Does the loan participation agreement address:				
102	11.1.1	(a) Purchase price?				
103	11.1.2	(b) Percentage of loan sold or purchased?				
104	11.1.3	(c) Date of first payment?				
105	11.1.4	(d) Priority interest?				
106	11.1.5	(e) Yield to buyer?				
107	11.1.6	(f) Representations and warranties?				
108	11.1.7	(g) Terms of default?				
109	11.1.8	(h) Exit or termination clause?				
110	11.1.9	(i) Transferability and sale of participation interests?				
111	11.1.10	(j) Attorney's review?				

	A	B	C	D	E	F
112		Loan Documentation	Yes/No/NA		Comments	
113	12.0.0	Does the credit union have written loan approval?				
114	12.0.1	Is the approval within policy guidelines?				
115	12.0.2	If there are policy exceptions, have they been reported to the board?				
116	12.1.0	Does the credit union have copies of the loan documents?				
117	12.1.1	(a) Promissory Note?				
118	12.1.2	(b) Lien, signed by all required borrowers and pledgors?				
119	12.1.3	(c) Security agreement?				
120	12.1.4	(d) UCC filing?				
121	12.1.5	(e) UCC search?				
122	12.1.6	(f) Title policy?				
123	12.1.6	(g) Adequate hazard insurance?				
124	12.1.7	(h) Flood insurance?				
125	12.1.8	(i) Current financial information and credit analysis?				
126	12.1.9	(j) Loan agreement?				
127	12.1.10	(k) Loan agreement monitoring?				
128	12.1.11	(l) Written documentation regarding technical loan defaults, if any?				
129	12.1.12	(m) Environmental report on real estate MBLs?				
130	12.1.13	Is the underwriting analysis documented?				
131	13.0.0	Accounting Issues	Yes/No/NA		Comments	
132	13.0.1	Has the credit union supported its accounting treatment & whether sale or secured borrowing? (e.g., If legal opinion is needed, has the credit union obtained it?)				
133	13.0.2	Are loan participations identified in the ALLL methodology?				
134	13.0.3	Is there a uniform policy addressing collected points and fees?				
135	13.0.4	Are accounting sub-ledgers maintained for individual loans or loan pools?				
136	13.0.5	Does the data processing system properly calculate interest based on contractual terms?				
137	13.0.6	Is there evidence of proper accounting and reporting of all participants' interests?				
138	13.0.7	Are delinquency reports segregated by individual participants (buying credit unions)?				
139	13.0.8	Does the selling credit union (servicer) provide reports to buying credit unions on a timely basis?				

Cell: A4

Comment: INTRODUCTION and PURPOSE

The Loan Participations Tab is designed to assist examiners in determining the level of review necessary given the types of loan participation activities in which the credit union is involved.

Loan participations may provide selling credit unions with a mechanism to manage interest rate, liquidity, and credit risks, as well as an enhanced ability to serve members. Credit unions buying loan participations may benefit from balance sheet diversification, use of excess liquidity, and increased revenues.

Despite their benefits, loan participations involve each of the seven risk factors: credit, interest rate, liquidity, transaction, compliance, strategic and reputation risks. As loan participations grow in size and complexity, the level of risk increases as well.

Cell: A5

Comment: Abbreviations and Definitions:

ALLL - Allowance for Loan and Lease Loss

Eligible organizations - A credit union, credit union organization, or financial organization.

FCU - federal credit union.

FICU - federally-insured credit union.

Financial organization - Any federally-chartered or federally-insured financial institution; and any state or federal government agency and their subdivisions.

FISCU - federally-insured state-chartered credit union

Loan participation - A loan where one or more eligible organizations participates pursuant to a written agreement with the originating lender.

Loan participation agreement - The written contract between the selling and buying credit unions.

MBL - member business loan

Originating lender - The participant with which the member contracts. Also known as "selling credit union" or "lead lender".

Pari passu - all loan participants share equal risk

RR - NCUA Rules & Regulations

Cell: A6

Comment: NCUA References

(1) Supervisory Letter 08-XX Evaluating Loan Participation Programs (XX 2008)

(2) NCUA RR Section 701.22 Loan Participations

(3) NCUA RR Section 741.8 Purchase of assets and assumption of liabilities.

(4) NCUA RR Part 723 Member Business Loans.

(5) Supervisory Letter 07-01 Evaluating Third Party Relationships

Cell: A7

Comment: External References

(1) OCC's Comptroller's Handbook, Loan Portfolio Management.

(2) FDIC's Risk Management Manual of Examination Policies, Section 3.2 - Loans.

(3) FAS 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.

Cell: B10

Comment: 1.0.0

Credit unions should report the total dollar amount of credit union's portion of outstanding participation loans purchased and originated. All business loan participations to both members and nonmembers must be reported in this category. In the case of business loan participations to members, credit unions should report only the portion still remaining on the credit union's balance sheet. Portions that are held by other lenders for any of the participations should not be included.

Cell: B11

Comment: 1.1.0

Construction & development loans, lines of credit, and credit card accounts typically have unfunded commitments. A written commitment to lend, signed by both lender and borrower (bilateral), should also be included in this category, even if the loan has not been funded.

Cell: B13

Comment: 1.3.0

The credit union should report the amount of the credit union's portion of all loan participations purchased year-to-date whether or not the credit union is holding a current outstanding balance.

Cell: B24

Comment: 2.0.0

Prior to starting a loan participation program or entering into a loan participation agreement with a third party, officials should evaluate whether the program is compatible with the board's risk tolerance, loan policies, and over-all strategic plan.

Buying credit unions may feel comfortable relying on the selling credit union's reputation for offering or operating a successful and profitable loan participation program. Regardless of the seller's favorable reputation, a buying credit union needs to perform a risk assessment to assure the seller's program is compatible with their own strategic plan, objectives, and available resources.

Board and management can mitigate each type of risk by fully understanding all aspects of the third-party relationship. The initial risk assessment should, at a minimum, address the seven risk areas, and examiners should expect to find documented rationale for omitting any of the risk areas.

Cell: B29

Comment: 2.1.2

If so, has management planned for how they will monitor loan performance and collateral valuation? How does management plan to keep informed on changing economic and market conditions in other areas?

When management purchases an interest in a participation loan that is outside the credit union's normal trade area, the buyer must establish a process to track market conditions in the expanded/additional/new trade area until the participation interest has paid off. During the due diligence process, if management determines that they will not be able to adequately monitor market conditions in the new trade area, purchase of the participation interest would not be prudent.

Cell: B30

Comment: 2.1.3

NCUA RR Section 701.22 (c) (4) requires a selling credit union to use the same underwriting standards for loan participations as used for loans that are not being sold in a participation.

Section 701.22 (d) (1) permits a buying credit union to participate "only in loans it is empowered to grant, having a participation policy in place which sets forth the loan underwriting standards prior to entering into a participation agreement."

Cell: B34

Comment: 2.1.7

Management needs to understand all aspects of the loan participation agreement and the underlying transaction(s) in order to develop adequate internal controls and management reports.

Cell: B35

Comment:

2.1.8

A buying credit union should understand the servicer's collection practices to determine whether they are compatible with their own. (The selling credit union is usually the servicer.)

Cell: B37

Comment: 2.1.10

See Letter to Credit Unions No. 08-CU-13, "Environmental Liability: Risk Management Guidance".

Cell: B39

Comment: 3.0.0

Interest rate risk varies depending on loan type, size, embedded options, and terms. The selling credit union usually structures a loan in accordance with their general underwriting standards, and retains servicing. As a result, buying credit unions usually have a greater potential for increased interest rate risk if they are not familiar with how interest rates are established and adjusted for certain loan types.

Cell: B41

Comment: 3.1.1

Competitive pressures in the market place may influence pricing more than credit risk factors.

Cell: B42

Comment: 3.1.2

Management should evaluate various "what-if" scenarios. What if borrowers' financial condition weakens, or general economic conditions weaken? Would the repayment terms need to be extended? What kind of workout arrangements may be necessary for impaired loans?

A credit union should evaluate the potential impact of extended maturities on the fair value of their balance sheet.

Cell: B45

Comment: 4.0.0

Both selling and buying credit unions need to have systems in place to plan and monitor loan disbursements to assure sufficient liquidity is available to fulfill their obligations in the loan participation agreement as well as the underlying loan documents.

Different loan types have varying disbursement patterns: construction and development loans have progress payments, and draws on lines of credit usually do not require advance notice. If a borrower does not draw down unfunded commitments as anticipated, it can cause the participants to have excess liquidity.

Cell: B47

Comment: 4.1.1

Management needs reporting systems to measure and monitor cash flows, including loan disbursements, scheduled payments, and loan balances.

Cell: B48

Comment: 4.1.2

Is the credit union aware of potential calls for additional loan draws? Deeds of trust typically give the lender the right to make additional advances on a loan to fund delinquent taxes, insurance, and other payments to protect their collateral position. All loan participants would need to fund their proportional share of the additional advances.

Cell: B50

Comment: 5.0.0

Both selling and buying credit unions may be exposed to further transaction risk if the counterparty does not have experience in the types of loans being participated or in loan participation programs in general.

In order to evaluate transaction risk, a credit union should understand how they and the counterparty will measure, monitor, and control risk.

Cell: B52

Comment: 5.1.1

Does the selling credit union have separate fiduciary accounts established to collect and disburse loan funds and payments? Does the buying credit union have the authority and the ability to verify the flow of funds?

Cell: B53

Comment: 5.1.2

Real estate loans, commercial mortgages, construction and development loans, installment loans, and member business loans have different interest calculation methods and payment schedules. The loan systems' capabilities affect the accuracy

of interest accrual. Credit unions should be aware of and resolve any differences between interest calculation methods.

Without adequate systems, a credit union could inadvertently charge an incorrect amount of interest or other finance charge. This could result in a loss of income or non-compliance with Truth in Lending regulations.

Cell: B54

Comment: 5.1.3

If a loan participation does not meet the requirements of FAS 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, it would constitute a secured borrowing, not a true sale. This would represent increased transaction risk to a credit union that sold the participation to stay within one or more regulatory or self-imposed caps or limits.

Cell: B55

Comment: 5.1.4

Refer to NCUA Letter to Credit Unions 08-CU-13, Environmental Liabilities: Risk Management Guidance.

Cell: B56

Comment: 5.1.5

Management should review bond requirements whenever a new product or service is being evaluated. It is considered a best practice for credit unions selling or buying member business loans to have lack of faithful performance coverage.

Cell: B58

Comment:

6.0.0

Loan participations must comply with numerous regulations, including:
NCUA Rules & Regulations
Applicable state rules & regulations
Bank Secrecy Act
Consumer protection regulations, including Regulation Z & Regulation B

Cell: B61

Comment: 6.1.2

Loan participation agreements should clearly define authority and accountability for regulatory compliance. Best practices include listing all applicable regulations within the loan participation agreement.

Cell: B62

Comment: 6.1.3

NCUA RR Section 701.22 (d) (2) permits credit unions to "participate in participation loans only if made to its own members or members of another participating credit union."

Cell: B63

Comment: 6.1.4

Selling and buying credit unions need to be aware of any variance in the regulations and laws under which each operates.

Federal credit unions are not permitted to charge a prepayment penalty. NCUA RR Section 701.22 (c) (6) states, "A member may repay a loan, or outstanding balance on a line of credit, prior to maturity in whole or in part on any business day without penalty." Depending on applicable state law, FISCUs may be permitted to charge a prepayment penalty.

NCUA General Counsel Opinion Letter 02-0824, Loan Participations in Loans with Prepayment Penalties, states that an FCU may participate in a loan with a prepayment penalty if it does not receive any portion of the prepayment penalty and its pro rata share of the penalty is forgiven.

NCUA RR 701.22 (c) (2) requires an FCU to "retain an interest of at least 10 per centum of the face amount of each loan." FISCUs may be required to retain a lesser or greater amount, depending on applicable state law.

NCUA RR Part 723 Member Business Loans applies to all federally-insured credit unions except in certain states where the state may have adopted their own MBL rule.

Part 723 permits NCUA Regional Directors to grant certain waivers. Available waivers may vary if the state has adopted a separate MBL rule.

Part 742 Regulatory Flexibility Program. RegFlex credit unions are exempt from the regulatory requirements of Section 723.7(b) concerning the personal liability and guarantee of principals for member business loans.

Cell: B64

Comment: 6.1.5

Loan documents may vary from state to state due to differences in state laws and local practices. It is possible that the selling credit union, buying credit union, borrower, and collateral are all located in different states. The participants should understand the legal ramifications of selecting which laws govern the loan participation agreement and the underlying loan transactions.

Cell: B65

Comment: 6.1.6

NCUA RR Part 722 establishes appraisal requirements.

Additional guidance is offered by the following NCUA Letters to Credit Unions:

No. 03-CU-17, Independent Appraisal and Evaluation Functions for Real Estate-Related Transactions;

No. 05-CU-06, Frequently Asked Questions on Independent Appraisal and Evaluation Functions; and,

No. 05-CU-12, NCUA and other FFIEC agencies issue Frequently Asked Questions on Residential Tract Development Lending. (This Letter includes information that applies to loans other than residential tract development.)

Credit union appraisal programs should include, at a minimum:

1. An appraisal policy,
2. Procedures to assure independence in the ordering and reviewing of appraisals,
3. Internal controls including reviews of approved appraisers.

Cell: B67

Comment: 7.0.0

Please refer to AIRE Questionnaire Evaluating Third Party Relationships for more details on evaluating strategic risk.

Cell: B69

Comment: 7.1.1

Information systems should be adequate to support the loan participation program and all loan types.

Cell: B70

Comment: 7.1.2

Can decisions be reversed with little difficulty and manageable costs?

Credit unions should consider What-If scenarios:

What are the options for selling loans if the credit union no longer wants or can afford the risk?

Is there a market for this type of loan? Would the price be discounted?

Cell: B72

Comment: 8.0.0

Entering into a loan participation has the potential to increase reputation risk for both selling and buying credit unions. In order to minimize that risk, credit unions should determine where additional controls may be needed.

Cell: B74

Comment: 8.1.1

In addition to assessing a third party's qualifications, the credit union needs to confirm the third party has no conflicts of interest.

NCUA RR Section 723.5 (b) permits a credit union to use the services of a CUSO even though the CUSO is not independent from the transaction, provided the credit union has a controlling financial interest in the CUSO as determined under Generally Accepted Accounting Principles.

Some state supervisory authorities have adopted other MBL Rules & Regulations which may vary in some respects.

Cell: B75

Comment: 8.1.2

Selling credit unions need to fully disclose all factual information pertaining to a loan in order to limit reputation risk. If a buying credit union successfully asserts their rights under contract representations and warranties, it could subject the seller to various increased risks if they were forced to take back the loan.

Cell: B76

Comment: 8.1.3

Both selling and buying credit unions should fully understand the terms of the loan participation agreement and underlying loan transaction(s) and be able to explain them to all interested parties, including examiners.

Cell: B77

Comment: 8.1.4

Systems, internal controls, audit, and business recovery plans should be in place to minimize disruptions to service.

Cell: B80

Comment: 9.0.0

Supervisory Letter 07-01, "Evaluating Third Party Relationships", provides detailed guidance on third-party due diligence.

Cell: B82

Comment: 9.1.1

As noted in Supervisory Letter No. 07-01, new business models often emerge due to changes in the regulatory, technological, or economic environment. When evaluating a seller's loan participation program, a credit union should be aware of recent or pending changes. Regulatory changes might affect loan underwriting practices if the seller has been approved for waivers or is a RegFlex credit union.

Credit unions who sell loan participations should fully disclose all available information about the borrower and the collateral. Regardless of the credit union's relationship with a borrower, loan presentation and packages should include historical information. A potential buyer of a loan participation should request this historical information if it is not disclosed.

Examples of full disclosure documentation include:

- Stating whether prior loans have been "paid as agreed" or rewritten, modified, or extended.
- Providing details on the borrower's depository relationships.
- Disclosing policy exceptions and regulatory waivers related to the loan.

Credit unions occasionally modify their loan policies in response to changing economic conditions and risk tolerances. A selling credit union may determine it is prudent to relax standards when conditions are improving; on the other hand, if economic conditions are worsening, they may decide to sell participations in riskier loans and retain the higher quality credits for their own portfolio. Selling credit unions should advise buying credit unions when and if they modify their underwriting standards. Buying credit unions are still required to make an independent credit decision.

Cell: B83

Comment: 9.1.2

Selling and buying credit unions need to understand all cash flows between the participants and the borrower(s). The loan participation agreement, or other documentation, should clearly describe:

- Methods to be used to notify the buying credit union when loan funds are required.
- Advance notice requirements, particularly for construction loans. (NCUA RR Section 723.3(c) permits loan funds to be released only after on-site written inspection by qualified personnel and according to a pre-approved draw schedule and other conditions in the loan documents. Buying credit unions should review and approve the inspection reports prior to releasing loan funds.

- Remittance of loan payments to the buying credit union (i.e., immediately or at a specified future date).
- Procedures for payment of taxes and insurance on non-performing loans. Deeds of trust typically allow the lender to advance additional loan funds to pay delinquent taxes, insurance, and other liens to protect the lender's interest in the collateral. All participants should understand their respective responsibilities to make further advances, if the need arises.

Cell: B84

Comment: 9.1.3

Independent third-party audits or reviews of loan participation programs can provide both selling and buying credit unions with important information regarding sufficiency of underwriting, and buying credit unions with important information regarding sufficiency of collateral valuation, documentation, credit risk grading process, servicing practices and procedures, etc. It is reasonable for the buying credit union to request the selling credit union's written response to findings and recommendations for corrective action.

The selling and buying credit unions should complete a post-closing review of all loan documents to determine that all terms and conditions are in accordance with the original terms presented. If the buying credit union recognizes that terms changed, they should notify the selling credit union of their findings and the corrective action they desire and may be entitled to under the loan participation agreement or contract.

Buying and selling credit unions should have systems for on-going risk monitoring that measure and control the following elements of a well-managed credit portfolio:

- Are concentrations within policy and layered risk acceptable?
- Is the loan participation program's impact on net worth, profitability, liquidity, and interest rate risk within plan?
- What is the overall performance and quality of the portfolio, with particular focus on non-performing loans?
- Are interest controls adequate to ensure accurate reporting of interest accrual, delinquency, and maturing loans?

The selling credit union usually retains servicing rights and responsibilities. Servicing responsibilities include enforcing compliance with all conditions and covenants in the loan agreement. Loan agreements usually include borrower covenants to provide regularly updated financial information and/or to maintain certain financial ratios.

A borrower's non-compliance with loan agreement covenants represents a technical default which the selling credit union (servicer) needs to address to assure there is no impairment to the ultimate collectability of the loan. Minimal covenant compliance monitoring includes:

- Notifying the borrower, in writing and on a timely basis, regarding events of technical default.
- Providing buying credit unions with the financial information required by the loan agreement.
- Reporting the results of loan monitoring to buying credit unions.

If a selling credit union does not fulfill its servicing responsibilities, it could materially increase their credit, transaction, and reputation risks.

Cell: B85

Comment: 9.1.4

The contract is a critical component of any third-party relationship because it controls how the relationship is managed. Buying credit unions should obtain legal counsel's opinion of the contract to assure legal and business interests are appropriately protected. Buying credit unions should exercise their right to negotiate contract terms with the selling credit union for mutually beneficial contracts.

Well-crafted loan participation agreements reduce the possibility of misunderstandings and disagreements between the parties. Credit unions should consider addressing the following issues in the agreements:

- Lender liability agreements
- Procedures for modifying loan terms
- Notification of adverse loan events
- Loan review requirements
- Ownership of servicing rights and provisions for sale
- Recourse provisions (full, partial, or non-recourse)
- Loan collection standards
- Compliance with GAAP. Proper accounting is essential to mitigate transaction and regulatory risk. FAS 140 Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities, governs the proper accounting treatment for loan participations. FAS 140 applies to both the seller and buyer of assets.

Cell: B86

Comment: 9.1.5

Selling and buying credit unions should ensure that their loan underwriting process validates safe and sound decision making, and that it complies with credit union policy and regulatory requirements. Examiners should expect to find regular management reporting to the board of directors of any policy exceptions.

Selling credit unions should provide buying credit unions with sufficient factual information to evaluate the borrower's creditworthiness, including the following factors:

- Adequacy of cash flow to service debt, with particular emphasis on verified and recurring sources of cash flow.
- Leverage, also known as debt-to- worth ratio. (The leverage ratio is calculated by dividing total debt or liabilities by net worth. If the ratio is greater than 1 to 1, the borrower owes more than they own. As the leverage ratio increases, the lender's risk also increases. Industry averages for specific business types are published by various vendors.
- Asset quality, including aging of accounts receivable and payable, components of inventory, and fixed assets.
- Liquidity levels acceptable for the proposed debt, particularly if leverage is increasing.
- Contingent liabilities, including borrower's personal guarantees, and guarantees by related entities.

A buying credit union needs to make an independent credit decision based on their review of the borrowers' credit worthiness. NCUA RR Section 723.5(a) states a credit union can use the services of a third party, "but the actual decision to grant a loan must reside with the credit union."

Buying credit unions should consider the risk exposure represented by the total loan commitment. For example, if a credit union buys a \$2 million portion of a \$25 million loan, their independent analysis needs to be based on the borrower's ability to service the total debt.

Cell: B90

Comment: 10.0.

NCUA RR Section 701.22 (c) (4) requires a selling credit union to use the same underwriting standards for loan participations as used for loans that are not being sold in a participation.

Section 701.22 (d) (1) permits a buying credit union to participate "only in loans it is empowered to grant, having a participation policy in place which sets forth the loan underwriting standards prior to entering into a participation agreement."

Cell: B91

Comment: 10.1.0

Refer to Business Loans Tab for details on requirements for MBL policies.

Cell: B92

Comment: 10.1.1

Underwriting standards establish acceptable credit risk factors, based on the board's risk tolerance. NCUA RR Section 723.6 Member Business Loans requires credit unions to adopt policies with underwriting standards. NCUA RR Section 701.22 requires selling and buying credit unions to have loan participation policies with underwriting standards.

In order to be meaningful, underwriting standards need to be measurable. For example:

- Cash flow analysis: The policy should specify acceptable methods to assess the adequacy of cash flow, such as debt service coverage ratios for various loan types.
- Loan to value ratios: Policies should specify how collateral will be valued, and how loan to value ratios will be calculated. Will the ratio be calculated on the sales price, the appraised market value, or the lower of the two?
- Financial statements: When a credit union is originating large, complex MBLs, the MBL policy should define the quality of financial statements that are required for each loan type and the level of dollar commitment. A company-prepared income statement and balance sheet may be acceptable for a \$100,000 loan to purchase equipment. An opinion audit may be required to assess the potential risks of a \$10 million loan.

Cell: B93

Comment: 10.1.2

Loan participation policies should specify when legal review is recommended or required. The loan participation agreement is the contract that determines how the relationship will be managed and warrants legal review.

If the underlying loan documents are not on standardized forms, the policies may require the buying credit union to obtain a legal review.

Cell: B94

Comment: 10.1.3

Loan policies should specify how frequently loans are to be reviewed and monitored.

The selling credit union, as servicer, is responsible for monitoring the borrower's compliance with loan covenants. Policies and procedures should detail the requirements for enforcing compliance, as well as required actions in the event of technical default.

Cell: B95

Comment: 10.1.4

Servicing policies and procedures should address:

- Processing of payments
- Payment and monitoring of taxes
- Tracking collateral insurance
- Lien expiration and re-filing
- Remitting payments to participants
- Monitoring of loan covenants
- Compliance with loan servicing agreement (usually included in the loan participation agreement)

Cell: B96

Comment: 10.1.5

Periodic review requirements may vary depending on the size and complexity of the loan, and the type of collateral. For example, a loan secured by a commercial office building requires different monitoring than a revolving line of credit secured by accounts receivable, with ongoing changes in the collateral base.

Policies and procedures should be established to determine the type and frequency of reviews necessary to assure the lender(s)' interests are protected.

A periodic review usually includes:

- Updated financial statements.
- Updated income verification, including borrower's and guarantor's tax returns.
- Updated credit reports.
- Updated collateral value.

Cell: B99

Comment: 11.0.0

NCUA RR Section 701.22 (d) (3) requires a buying credit union to "retain the original or a copy of the written participation loan agreement and a schedule of the loans covered by the agreement."

Cell: B101

Comment: 11.1.0

A loan participation agreement is the typical form of contract. When credit unions anticipate multiple loan participation transactions, they may execute a Master Participation Agreement, with each loan participation represented by a separate certificate.

Cell: B103

Comment: 11.1.2

Section 701.22 (c) (2) requires the selling credit union to "retain an interest of at least 10 per centum of the face amount of the loan."

Cell: B105

Comment: 11.1.4

Loan 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 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.

Cell: B107

Comment: 11.1.6

A loan participation agreement usually contains representations and warranties by the selling credit union. These are statements of assurance on which the buying credit union may rely, usually regarding the accuracy of documentation or financial statements provided to the buying credit union. The agreement should define the consequences and remedies that would accrue if it turns out that the representations and warranties were not accurate.

Representations and warranties are separate and apart from recourse provisions, and do not affect true sale accounting issues.

Cell: B113

Comment: 12.0.0

NCUA RR Section 701.22 (d) (3) requires a buying credit union to "retain the original or a copy of the written participation loan agreement and a schedule of the loans covered by the agreement."

Cell: B115

Comment: 12.0.2

NCUA RR Section 701.22 (d) (3) requires a buying credit union to "retain the original or a copy of the written participation loan agreement and a schedule of the loans covered by the agreement."

Cell: B121

Comment: 12.1.4

The documentation should include a UCC search before the loan is made to identify any existing filings that have priority and need to be released, subordinated, or approved to remain of record.

When the selling credit union files a new UCC-1 financing statement, they should request an updated search to confirm the priority of their filing.

UCC filings automatically expire after five years. Credit unions should have tickler systems to monitor when it is necessary to file a continuation statement to maintain the UCC filing and priority.

Cell: B122

Comment: 12.1.6

The credit union should review the title policy to confirm it reflects the condition of title anticipated by the loan approval. If the policy reflects any liens, senior or subordinate, which were not approved by the credit union, the credit union should have documentation to show they are in process of seeking corrective action.

Title practices vary from region to region and state to state. A buying credit union should understand how different title conditions may affect value and lien enforceability, particularly for construction loans.

Cell: B125

Comment: 12.1.8

Loan files should include copies of borrower and guarantor financial statements, income verification (typically tax returns), and asset verification. The information should be current at the time the loan was approved and should be updated in accordance with policy guidelines or terms of the related loan agreement.

Cell: B126

Comment: 12.1.9

The loan agreement should include all the terms and conditions of the loan approval, including specifically required loan covenants.

Cell: B132

Comment: 13.0.1

A credit union should assure a loan participation is accounted for consistent with GAAP and sale meets the true sale requirements of FAS 140. If the transaction does not meet the requirements of FAS 140, it could subject the credit union to compliance risk (for non-compliance with GAAP).

