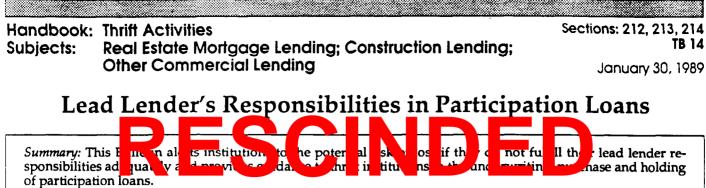
# Office of Regulatory Activities

TB 15 was rescinded 1/13/95. Incorporated into Thrift Activities 212.



For Further Information Contact: The FHLBank District in which you are located, or the Policy Analysis Division of the Office of Regulatory Activities, Washington, D.C.

Thrift Bulletin 14

### Background

The Ninth Circuit Court of Appeals recently rendered a ruling in the case of Women's FSLA v. Nevada National Bank. The court awarded judgment against the lead lender in the transaction due to the lead lender's breach of fiduciary duties. The judgment included rescission of the participation agreement and return of a pro rata portion of the loan. The court concluded that the lead lender was remiss in the following areas:

- Failed to notify the participant of the borrower's financial difficulties and subsequent delinquency.
- 2. Failed to inform the participant of the approval of a junior encumbrance and the advance of additional sums to the borrower.
- 3. Failed to establish certain escrow accounts.

### Procedures

#### Lead Lender:

It is important for institutions to remain aware of their duties, both contractual and fiduciary, with regard to participation lending. The lead lender (the seller or institution responsible for initiating the participation agreement with other institutions) is responsible for obtaining all documentation required by 12 C.F.R. 563.17-1(c)(1). The lead lender should provide copies of this information, as required by 12 C.F.R. 563.17-1(c)(3), and its underwriting standards to each participating institution. Institutions and their legal counsels should ensure that regulatory requirements are adhered to for new as well as existing participation loans.

While participation agreements may vary significantly, institutions have implied responsibilities inherent in a fiduciary role. Some of these implied responsibilities are as follows:

- 1. Compliance with all technical requirements under the security instrument.
- 2. Compliance with the formalities of the agreement; reports to the participant, consents required, and other contractual duties.

- 3. Keeping the participant informed on a timely basis of legal/business issues related to the borrower.
- 4. Refraining from any activities that might be construed as harming the interest of the participants (e.g., making a loan directly to the borrower that is secured by a second lien on the collateral property underlying the participation).

## Purchaser:

Insurance Regulation 563.17-1(c) and the T-memorandum "18" series address the Board's recordkeeping requirements and include requirements for participation loans. Institutions purchasing participation loans must obtain adequate documentation from the lead lender and properly analyze the purchased loan for credit quality. Purchasers should subject participation loans to the same critical review and documentation requirements as those loans originated by the purchasing institution. In addition, the purchasing institution should continually monitor the participation loan, to ensure that the lead lender is fulfilling its duties and responsibilities. At a minimum, purchasers should be alert to any modification of the loan terms or changes in credit quality.

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- Darrel W. Dochow, Executive Director

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Federal Home Loan Bank System