



DBF GUIDANCE FOR GEORGIA STATE-CHARTERED BANKS, BANK HOLDING COMPANIES, CREDIT UNIONS, AND TRUST COMPANIES

TO: Supervision Staff

CC: Georgia State-Chartered Banks and Credit Unions

FROM: Melissa Sneed
Deputy Commissioner for Supervision

SUBJECT: Loan Participation Agreements Containing "Last In, First Out" Provisions and Subordination Clauses

DATE: March 11, 2025

This is written to provide guidance for loan participation agreements structured in a "last in, first out" position and/or collateral subordination clauses.

In most participation agreements, loan payments are applied pro rata between the originating financial institution's retained portion and the portion participated. In the instance where the originating financial institution is required to apply any payments received on a particular loan toward the repayment of the participation sold, such "first out" provisions do not normally negate the treatment of the loan as a participation. Similarly, "last in" provisions which provide for funding by the participant only after the originating financial institution has fully funded its retained portion also do not normally negate the treatment of the loan as participation. An exception to this general rule occurs when the "first out" provision extends beyond the normal funding phase and into the repayment phase in a default situation. In the case where the participating financial institution is to be "first out" in the event of default and liquidation of collateral, the originating financial institution retains a higher potential for loss than the participating financial institution in all cases where collateral values prove insufficient. Whenever losses are to be borne by the originating financial institution in greater proportion than their participation, the participation shall be treated as borrowings by the originating financial institution.

When a participation agreement includes a subordination clause that places the originating financial institution in a secondary position relative to all collateral or other interest notwithstanding other provisions of the participation agreement, this effectively places a disproportionate share of the ultimate risk on the originating financial institution. Participations containing such subordination clauses shall be treated as borrowings by the originating financial institution.

Legal Lending Limit Treatment

In calculating the loan amount of a debt obligation subject to O.C.G.A. §§ 7-1-285 for banks or 7-1-658 for credit unions, the Department's policy is to deduct qualified participations sold, whether or not the participation is treated as a true sale or borrowing for accounting or regulatory reporting purposes. **Determination of the substantive transfer of potential loss exposure is often fact specific and may require more detailed analysis.** When the participation is sold subject to recourse, repurchase, or indemnity, it is unlikely that the potential loss exposure has been substantively transferred away from the participation seller, and in those cases, the participation sold amount generally would not be deducted from the loan amount when calculating the debt obligation subject to legal lending limits. Any such debt obligations exceeding 25 percent of the selling financial institution's statutory capital base would likely warrant the citation of an apparent violation of O.C.G.A. §§ 7-1-285 or 7-1-658.