

INTERPRETIVE LETTER 98-05 (June 25, 1998)

If a bank makes a loan which is guaranteed by various guarantors and a portion of the loan is subsequently participated to another bank, the guarantees would follow the loan on a pro rata basis.

This letter responds to your recent inquiry to the Office of Banks and Real Estate ("Agency") regarding loan participations. You asked how the Agency analyzes a bank's loan guarantees when the loans to which the guarantees apply are participated to other banks. Furthermore, you asked whether the structuring of a participation on a Last In First Out ("LIFO") or First In First Out ("FIFO") basis would affect that analysis.

The Illinois Banking Act states, "The liabilities outstanding at one time to a state bank of a person for money borrowed... shall not exceed 20% of the amount of the unimpaired capital and unimpaired surplus of the bank." 205 ILCS 5/32. A bank can avoid violating this provision if it reduces excess outstanding liabilities to one person by participating part or all of the liabilities to a third party without recourse. OBRE Policy Statement 2001.

If a bank makes a loan which is guaranteed by various guarantors and a portion of the loan is subsequently participated to another bank, the guarantees would follow the loan on a pro rata basis. Whether the participation is structured on a LIFO or FIFO basis has no effect on that conclusion.⁽¹⁾ We should note that the bank that purchases a participation must review other credits of the borrower and guarantor to assure that, with the participation, the total loans and guarantees still comply with the bank's lending and guarantee limits respectively.

1. Although a participation may be structured in any way agreed upon by the banks, to be considered a "true participation", the agreement must provide for a pro rata distribution should the loan go into default.