

**COVER EMAIL TO FDIC REGIONAL DIRECTOR, MARK SCHMIDT REGARDING
SURVEY RESULTS ON PARTICIPATION LOANS WITH FAILED BANKS**

Mark,

As promised I am forwarding to you the results of the surveys CBA conducted regarding participation loans involving failed banks. The survey results are attached. **Please understand the CBA of Georgia is providing this information in a spirit of cooperation. We certainly do not intend to intrude into the operations of the FDIC Liquidation Section. The CBA's interest in this situation is strictly to attempt to facilitate an improved situation on participation loans, involving failed banks, for the still existing bank participants. Hopefully this will result in a more efficient, timely, businesslike process that minimizes the loss exposure on these loans for the still existing banks and should result in the FDIC being able to increase the amount of recovery on its portion of the participation loans, as well.**

We sent out two surveys, one to community bankers and one to a few bank consultants and attorneys. We promised all respondents that we would maintain the confidentiality of their responses. We are aware of community bankers that have participation loans with failed banks and other consultant/attorneys with such clients that did not respond to the surveys, either for fear of a breach of confidentiality and/or their own time constraints. From discussions with these non-respondents over the last few months, the comments we did receive are basically descriptive of their situations. In essence, their responses would have been just more of the same.

From the responses, it appears that the FDIC has assumed the "lead bank role" in most of the cases; however, at least one response seems to indicate the FDIC assumed a "downstream participant's role." As we promised the banks, we have compiled the survey responses without identifying information. However, as you will see most of the community banker respondents indicated a willingness to e-mail the FDIC's Supervision Division with the specifics of their situation and/or a willingness to participate with the FDIC's Supervision Division in a focus group on this issue, if the FDIC decides either is desirable.

Please note that, while maintaining the confidentiality of the respondent, we have letter coded the narrative responses to the banker survey. A different letter code has been used for each respondent bank. In this way you can review the survey results and follow a particular bank's narrative responses throughout the survey.

Based upon the results of these surveys, including some common patterns noted from the responses, we would like to put forth the following eight initial recommendations for improvement of the handling and managing of participation loans by the FDIC Liquidators:

1. The FDIC should attempt to identify all loans obtained in connection with a bank failure involving participation loans with other existing FDIC insured banks, as soon as possible. Such loans should be segregated and handled separately from all other loans of the failed bank, not involving participations.
2. As a general statement, the FDIC Liquidators should be instructed that actions by the FDIC in regard to participation loans, especially when the FDIC has assumed the role of a "lead participant," should always consider what is in the best interest of all the participants in the loan. This should rank in priority at least equal to the FDIC's priority of liquidating the assets of

the failed bank “as soon as they can.” *(NOTE: Generally, loan participation agreements would require that the “lead bank or participant” act in the best interest of all participants.)*

3. The FDIC should promptly notify all participants in the loan that they have now assumed the failed bank’s position with the loan. *(NOTE: We believe this part is generally happening now, but perhaps not in all cases.)* After initial notification, the FDIC should regularly keep all participants up to date on happenings with the loan including all discussions with the borrower, especially as long as the FDIC remains in the “lead participant role.”
4. If the FDIC is assuming the “lead bank role” in the participation loan, when the FDIC notifies the other participating banks, the FDIC should offer to transfer the “lead participant role” to one of the other participating banks. If the other participating bank(s) is(are) in agreement, this transfer should be accomplished as soon as possible.
5. If possible, the FDIC should offer to sell its portion of the participation loan to one or more of the other participating banks without the loan having to go through the FDIC’s regular auction process. The local FDIC Liquidators should be allowed greater flexibility to sell the FDIC’s portion of the loan at a discount without it going to auction. *(NOTE: One banker who did not respond to the survey indicates he was told that there is a firm rule that they cannot sell a loan or a portion of a loan for less than 80 cents on the dollar without it going to auction. Another non-respondent banker indicated verbally the FDIC would not agree to a deal to sell the underlying collateral on a loan for 93 cents on the dollar, rather they grouped the loan participation into a pool of like loans, which sold for slightly over 50 cents on the dollar.)* However, if it becomes necessary for the FDIC’s portion of the loan to be sold at auction, the FDIC’s portion of all participation loans should be sold separately giving the other participating banks an opportunity to bid on the FDIC’s portion of the loan. *(NOTE: If the FDIC’s portion of a participation loan is grouped with other similar loans and sold at auction as a group, this will preclude most community banks from being able to bid to obtain the FDIC’s portion of a participation loan, even if they deem purchasing the FDIC’s portion to be in the best interest of the bank. The sheer size of the pool and/or the need not to increase non-performing loans on the bank’s books will preclude them from buying the pool.)*
6. The FDIC needs to streamline its decision making process in regard to the participation loans they hold. This applies whether the FDIC is in a “lead participant role” or just a “downstream participant role”. *(NOTE: Loan participation agreements generally require all participants to agree on various actions involving the loan. Based upon the survey responses, that appears to be the biggest frustration for the participating banks in dealing with the FDIC on these participation loans. When something needs to be done for the best interest of all participants in the loan, the FDIC approval takes much too long. Per some of the responses, it may even be increasing loss exposure to all parties, in some cases. Deals that would minimize loss are lost because the FDIC cannot or will not make decisions quickly enough. The situation where the real estate collateral on one of the loans was being foreclosed, with a buyer for the property already waiting in the wings, at the time the bank failed and the FDIC would not or could not give timely approval for the foreclosure to proceed, the foreclosure was stopped by the FDIC and the buyer subsequently walked away.)*
7. The FDIC should somehow preclude borrowers from bidding on their own loans that the FDIC has acquired in a failed bank situation, at least when the loan involves a participation. *(NOTE: One of the respondents alluded to a situation where the borrower stopped negotiations or even discussions with any of the participating banks as soon as one of the participants failed and began negotiating with the FDIC in hopes of buying their loan(s) from the FDIC at a steep discount. Verbal discussions with community bankers indicate that this is now commonplace. Also, based on discussions with a non-respondent banker the following has definitely happened*

at least once. The bank was a downstream participant in a hotel loan with Integrity Bank. The FDIC agreed to sell the loan at auction, individually, to allow the bank to bid on the FDIC's portion of the loan. The loan was sold at auction to the borrower for 27 cents on the dollar. There were personal guaranties on the loan, so when the borrower sold the hotel almost immediately after buying their loan from the FDIC, the downstream bank was able to "hold the borrower(s) feet to the fire" and was paid in full. This is a success story, but it illustrates a problem. Perhaps without the personal guarantees the downstream bank could have been forced to take a big discount on its portion of the loan, as well. Why should a borrower continue to work with and try to pay a still existing bank when they can in essence have 73 cents of every dollar of their debt forgiven by negotiating and buying their own loan from the FDIC?)

8. Last, but perhaps most importantly, the FDIC Liquidation Section needs to develop a standard set of operating procedures for dealing with loans they acquire in failed bank situations, which involve participation loans. This needs to cover the standards, processes and procedures from beginning to end, "soup to nuts." This should be something that can be given to bankers who have portions of these participation loans, so they can know what to expect and so they can make reasonable business judgments on how to proceed in the best interest of their bank. *(NOTE: Not only would this clear up much banker confusion, but it should serve to bring about greater consistency to the process from one contract liquidator to the next and from one loan situation to the next. Clearly from the survey responses there seems to be little consistency in how these situations are dealt with. Frankly, some of the things that "the FDIC can and cannot do" (per the liquidator), in some of these situations, seem to be negotiating ploys on the part of the liquidator to get the still existing banks to pay a price of par or close to it for the FDIC's portion of the loan. They, the FDIC Liquidators, have leverage over these banks due to the situation, but it may be increasing the loss exposure for the still existing bank(s). The operating standards, processes, and procedures should serve basically as an operating manual for the contract liquidators, hopefully bring more consistency and predictability to the process and serve as a guide for the liquidators that it is a priority on these participation loans that the FDIC consider what is in the best interest of all participants in these loans.)*

If you have questions about our recommendations or after reviewing the survey results, please do not hesitate to give me a call. The office phone number is listed below. My cell phone number is 770-789-5605. The cell may be the quickest way to reach me, most often, during the Georgia legislative session.

We look forward to hearing from you after you have had a chance to review this material. Thanks in advance for your willingness to help with this situation.

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