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GUEST COLUMN REFI

THE VALUE OF BEING DILIGENT IN SYNDICATED LOAN TRANSACTIONS

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The participation-syndication channel can offer many benefits: capital investment and risk is shared between multiple financial institutions, enabling lenders to diversify regional and industry risks and participate in loans with high-yield potential that would be too large or risky to manage on their own.

Syndicated and participated transactions may also make it easier to meet new reserve requirements for high volatility commercial real estate, and provide access to the collective client base and expertise of lenders involved. But, the shared arrangement may also create unique challenges and complicate efforts to reconcile disparate due diligence requirements and expectations of participating parties. What can lenders do to manage risks and take advantage of this platform?

MANY COOKS IN THE KITCHEN

In syndication and participation, underwriting decisions - including credit review, administration of the credit or the level of physical due diligence that should be undertaken - are typically made by a lead bank, or agent. Because the risk appetite and requirements of participants can vary dramatically, developing a true understanding of the credit, while complying with overall requirements of the group can be a source of dispute.

In many cases, the lead bank will order reports and determine the level of due diligence. Similarly, lenders often rely on the monitoring efforts of the lead bank after the loan is syndicated – but what happens if the policy of the lead bank is less rigorous than the policy of a participating lender? Should participants ever assume good faith actions by the lead bank if specific agreements assigning responsibility for certain aspects of the transaction are absent? Do participants require reliance of all vendors, and how is this affected by vendor management requirements? And who should determine the appropriate approach to solving problems that are encountered?

Per the Office of the Comptroller of the Currency, lenders should avoid an overt reliance on the lead bank, and should independently underwrite all aspects of the transaction. The OCC states that:

"Prudent purchases of loans, loan participations, and loan portfolios [and participation in syndicated credits] are governed by the credit principles and procedures embodied in the purchasing bank's formal lending policy." The policy ordinarily entails:

- Complete analysis and documentation of the credit quality of obligations to be purchased;
- An analysis of the value and lien status of the collateral; and
- The maintenance of full credit information on the obligor during the term of the loan.

PARTICIPATED VS SYNDICATED – DIFFERENT ISSUES

Because lenders often become involved in the participated loan process after the closing of a loan, their limited ability to obtain and review information not already provided to the originator may compromise their ability to satisfy their own underwriting requirements. Additionally, the interest share in the original loan may not be equal among participants, which can increase risks for the participating lender.

Syndicated transactions, however, are typically formed before the loan is completed, giving participants greater ability to influence the extent due diligence performed before lending decisions; though information and borrower communica-

Syndicated transactions may take the form of "underwritten" transactions, in which the entire commitment is guaranteed by the bank; "best-effort" transactions, in which only a portion of the loan is guaranteed, with the balance to be funded by others; and "club" deals, for which the agent or the borrower are pre-selected. However, the fact that these transactions are led by a single agent lender can complicate the challenge of coordinating the requirements of various participating lenders.

ASSESSING AND ADDRESSING RISKS

Since the policies, risk appetite and expectations of lenders are not identical, participated and syndicated transactions often require some degree of compromise. In order to become comfortable with the loan credit, there are a number of proactive measures that will help the agent and participating lenders minimize problems when underwriting shared transactions.

Agent Lenders

- Be proactive: consider the risk tolerances of participating lenders and how to most effectively meet these. If the syndication has not yet been finalized, doing more than the minimum requirement can help facilitate and speed up the loan closing.
- Unless each member of the syndicate will perform independent due diligence, use established and reputable third-parties for all due diligence.
- If participating members are relying on third-party due diligence, acceptable reliance language should be negotiated with your consultants in advance. If you will not allow the reliance on third party due diligence you engage, this should be communicated to all participating members at the onset to allow time for them to complete independent due diligence.

Participants

- Be very clear about your involvement in the shared transaction, since your position in capital stack may also influence decisions about independent due diligence. Senior lenders are generally repaid before other participants receive payment, which could expose subordinate lenders to increased risks.
- Be sure to communicate your risk tolerance and due diligence expectations to the agent lender early on, so that appropriate arrangements can be made to accommodate those.
- A clear understanding of scope and consultant requirements should be established if you expect to rely on the agent's due diligence reports. Remember that due diligence prepared for the agent may include recommendations that are specific to that lender. It is advisable to independently evaluate all conclusions and recommendations against your own risk profile.
- If you have difficulty obtaining information, contacting a colleague at the agent lender may facilitate access.
- Any policy exceptions should be documented in accordance with your policy.

Proactive planning, independent review and clear communication between agent and participants will help manage challenges and potentially elevated risks posed by syndication-participation transactions, and enable lenders to take advantage of the benefits this important platform provides.

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