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BANKING LAW UPDATE

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2 Pages

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LOAN PARTICIPATIONS

Do not take participation agreements lightly, whether your bank is the buyer or the seller of the participation. Too many lenders sign any participation agreement form that is readily available without carefully considering its terms or understanding the law relating to participations. Here are a couple of things to consider:

> **<u>If you are the Participant.</u>** Do you want any rights to control how the loan is managed? You may want to require some rights, especially if you have purchased a majority of the loan. If the originator has other loans to the borrower, negotiate how payments or collateral proceeds are allocated between the participated and the non-participated loan. Determine what rights the originator has reserved to change the terms of the loan.
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> **<u>If you are the Originator</u>**. Carefully review the terms of the agreement to determine whether the agreement restricts any actions on your part. Many agreements prohibit the originator from changing material terms of the loan. Missouri law states that renewing a loan, or changing material terms, without approval of the participant is a breach of the participation agreement that may permit the participant to sue the originator to recover the amount of the participation. Therefore, the originating party should be very careful and consult its legal counsel before renewing a participated loan or otherwise changing the terms of an originated loan.

Talk to your attorney about documenting your participations and understand the terms of the agreements you are using to either sell or buy a loan.

IMPORTANT: Some banks use participation forms that they have copied from other banks in other transactions. Sometimes these forms are outdated, or have been specially negotiated so that they do not accurately reflect the terms of the loan for which they are being used. We have seen forms that were prepared by Sandberg, Phoenix & von Gontard being used by banks, even thought those forms were revised years before and are obsolete. Do not use any forms that have not been approved by the bank's counsel. Improper use of forms could cause serious harm.

The contents of this Update are for general information only. Consult your legal counsel before taking actions in reliance on anything contained in this law update. To cancel receipt of the Banking Law Update, send an e-mail to mforster@spvg.com and request "Cancel Update".

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PAYING CHECKS DRAWN ON THE ACCOUNT OF A DECEASED OR INCOMPETENT CUSTOMER

A bank may not pay a check if the bank knows that the customer has died or has been declared incompetent by a court. In the case of a deceased customer, the funds belong to the estate. For an incompetent customer, the designated guardian or conservator must take control of the funds. One exception is that even though the bank knows of the death of the customer, for a period of 10 days after the date of death the bank may pay checks drawn before the date of death unless any person claiming an interest in the funds has given a stop payment notice. (UCC Section 4-405).

TITLE DATE DOWN LETTERS

A bank should never close any loan secured by real estate without "marking up" the title binder to assure that the final title insurance policy is issued properly. The minimum mark-ups are:

1. Delete all standard exceptions (survey, parties in possession, mechanics liens). No real estate loan should ever be closed with standard exceptions in place since this significantly impairs coverage for the bank. For example, failure to remove the survey exception may mean that the bank is not insured against building line encroachments. Failure to remove the mechanics lien exception means that the bank is not insured against mechanics liens resulting from work done before the date of the loan even though the lien is not filed until after the deed of trust or mortgage is recorded.

2. Make the commitment, and therefore the insurance, effective as of the time and date of recording the deed of trust. Without this, the bank would have no coverage against any title conditions that arose between the date of the commitment and the date of recording.

3. Add appropriate affirmative endorsements. These endorsements may include assurance that the property has direct access to a specific road. If the deed of trust or mortgage has a future advance clause, be sure to add a future advance endorsement. Without a future advance endorsement the bank's coverage will decrease with each payment on the loan even if the borrower makes subsequent draws on a line of credit loan.

4. Have the title company agree that the bank has satisfied all conditions necessary for issuance of the policy. Some title companies have recently attempted to deny coverage on the grounds that one or more conditions to the issuance of the policy were not satisfied.

5. Have the title company insure that the legal description in the deed of trust accurately describes the property in the survey.

Some lenders make these modifications to the commitment by making notations on the title commitment itself. But, that practice tends to be haphazard, and generally does not include insertion of additional endorsements. Use of a formal title "date down letter" assures a more focused approach and provides a clearer result. The date down letter should be presented to the title company in advance of closing to assure that everything requested can be done by closing.