

Bulletin B-25-1



TO: ALL TENNESSEE STATE CHARTERED BANKS

SUBJECT: Pilot Loan Purchase Program

DATE: July 23, 2025

Introduction and Purpose

The Department is offering a pilot program to qualified institutions to allow for greater flexibility in purchasing single source loans. For some time now, the Department has had meaningful conversations with the Tennessee Bankers Association and management of a few state-chartered banks regarding their specific institution's needs and how together we can continue to prudently move the community bank model forward. The Department hopes this pilot initiative will support the implementation of such a loan purchase program for qualified institutions on a case-by-case basis.

Historically, the Department's position is that loans obtained through a single originator, as more clearly described below, is limited to 25% of Tier 1 Capital. However, in an effort to respond to inquiries from the industry about this matter, support Governor Lee's innovation initiative, promote continued economic development in our communities, and to better assist qualified institutions with liquidity, capital, and earnings management, the Department will evaluate institutions by request on a case-by-case basis to determine the capability of a qualified institution to exceed 25% of Tier 1 Capital. Specific guidance for the treatment of loans from a single source, including prior Department approval and enhanced risk management expectations for purchased loans, is addressed below.

Single Source Loans

Single source loans include loans originated by a third party following an originate-to-sell model. For purposes of this document and pilot program, single source loans only include those from third-party originators and only include situations where the originator retains at least a portion of servicing rights, is involved in ongoing administration of the credit, and/or there is authority of the originator to negotiate restructuring of delinquent credits.

The Department acknowledges that if the bank can substantiate that reliance for repayment is on the borrower of the funds, and not the originating third party from which the loan originates, then these loans can be viewed as loans to individual borrowers. These loans purchased from a single source should be aggregated for concentration risk management purposes, and aggregate holdings in excess of 25% of Tier 1 Capital must receive prior approval of the Department, which will be contingent upon well-established prudent risk management policies and procedures as described below.

Bank management should understand and fully consider the underlying risks associated with such products, especially when transactions are not originated, located, or serviced in the bank's typical market area. Board approved policies should provide appropriate guidance for asset diversification, including expectations and limitations on such transactions. A prudent maximum limit for each individual originator should be established. The maximum limit should be based upon the aggregate dollar amount of the transaction(s) and should not be related to implicit guaranties of originate-to-sell lenders typically associated with this type of activity. Through this initiative, the incentive to modify master agreement language or loan documentation enhancements to circumvent the limitation of 25% of Tier 1 Capital is removed. State-chartered banks, regardless of participation in this pilot program, should not modify language in master agreements or loan documentation to diminish credit enhancement features in contract language. Prudent underwriting, appropriate risk limits, and collateral protection to help safeguard the bank's interest is of utmost importance.

Risk management policies and procedures are the core of sound banking practices and should be the foundation of any operational area within the bank. Board approved, bank specific policy guidance should, at a minimum, address areas such as geographic and industry portfolio diversification for such loans and in relation to the entire loan portfolio, ongoing due diligence, and monitoring of the financial condition of the purchased loan source, as well as loan customers, concentration management monitoring, and Board reporting requirements. As with any lending activity, banks should ensure sound risk management practices are in place prior to this activity, including, but not limited to the following:

- *Strategic Planning* – A well-defined strategic plan should outline participation in this type of activity that reflects the Board's risk appetite. Areas of consideration include, but are not limited to, an evaluation of credit, strategic, interest rate, liquidity, compliance, and operational risks.

- *Policy Guidelines* – Prudent policies, procedures, and practices that include appropriate risk limits. Policies and procedures should, at a minimum, address underwriting standards, approval limits, personnel authorized to engage in covered activity and a list of third parties from which transactions can be made, loan types, collateral considerations, loan structure, recourse, due diligence, pre-purchase analysis, allowance for credit losses and capital considerations, credit scoring, and problem loan management.
- *Independent Credit Analysis* – Effective credit administration practices should evidence active risk management, including Board and management expertise and involvement. Given the unique aspects of this loan activity, banks should have well developed practices in place to ensure a thorough independent underwriting analysis is completed, as well as ongoing credit monitoring.
- *Loan Purchase Agreements* – A written agreement should be executed with the originator to ensure the bank is provided with the necessary information to make informed credit decisions and complete ongoing credit monitoring. Further, banks should monitor the originator's compliance with the terms of any contract, as well as monitor compliance with loan covenants. Consideration should be given to perfection of interest in collateral, verification of assignment of notes, and any appropriate applicable legal and accounting considerations necessary to validate the transactions.
- *Board Reporting* – Sufficient information should be periodically provided to the Board of Directors to make informed decisions, determine adherence to Board established policies, and provide details about covered activity reflecting geographic location of borrowers/collateral assignments, industry analysis, overall activity as a percentage of Tier 1 Capital, credit risk ratings, and any other pertinent factors necessary.

This memorandum is not intended to hinder loan sales and purchases among depository institutions, as defined in TCA § 45-2-1105, but rather clarifies the Department's position on pooled or aggregate loan transactions, which may include indirect recourse to the seller and establishes prudent risk management expectations. Banks should consult their external audit firm for accounting considerations or potential implications for aggregation of groups of loans purchased from a single source. Limitations on loans to any one borrower, as outlined in TCA § 45-2-1102, are still applicable.

To be considered for this pilot program, banks should submit a written request to the Department for consideration. The request should include sufficient detail to outline the bank's past, current, and anticipated single source loan position. Management should outline prior experience including information regarding existing third party originator relationships, prudent established risk management practices as outlined above, and the maximum amount of loans to Tier 1 Capital for which the bank is requesting approval. The Department will discuss proposals with senior management of the requesting institution as part of the review process. The Commissioner reserves the right to comment on and/or object to a bank's request, and written approval from the Department must be received prior to increasing a bank's portfolio of loans purchased from a sole source above 25% of

Tier 1 Capital. Banks with higher levels of such loans from a single source will be subject to increased regulatory expectations and evaluation, especially if the bank's capital, liquidity, or earnings positions are not at least satisfactorily managed and rated, or if risk management weaknesses are identified.

The Department's approval for this activity is only available to institutions with sound risk management policies, procedures and practices with no material capital, asset quality or liquidity concerns. Approval to exceed 25% of Tier 1 Capital can be revoked at any time at the discretion of the Department based upon management's performance related to this activity, quarterly financial performance, examination findings, or otherwise. Therefore, banks should have written contingency plans in place to reduce activity with and exposure to single source originators should a change in financial condition of the bank, single source originator(s), or borrower(s) dictate such actions. The Department understands the process to reduce a concentration should be prudent, and as such, management's plans should outline a glidepath to reduce exposure, if necessary, without creating an undue adverse impact to the bank.

Questions regarding this pilot program may be directed to Assistant Commissioner Phil Ruffin at philip.ruffin@tn.gov or (615) 934-1637. The Department will meet with interested parties by request to discuss further if necessary.

A handwritten signature in blue ink that reads "Greg Gonzales". The signature is cursive and fluid.

Greg Gonzales
Commissioner