

Content of question:

What does sub-participation mean?

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Piece of law	Decree No. 123/2007 Coll.
Provision	Annex 15, II, 2, a), 1
Explanation	<p>As a rule, sub-participation is to be understood as a certain contractual form of transferring assets where the originator (the creditor under the loan contract) transfers the credit risk of an asset or pool of assets to a third party/parties; however, the assets themselves are not transferred outside the originator's balance sheet.</p> <p>Sub-participation typically takes the form of</p> <p>a) sharing the risk from a granted loan through refinancing (the so-called funded sub-participation) where the sub-participant provides funds to the creditor (i.e. the structure shows some similarities with a syndicated loan where the sub-participant shares a part of the loan's principal), or</p> <p>b) sharing the risk from a granted loan through a form similar to unfunded credit protection (the so-called risk sub-participation) where the sub-participant shares just the risk and provides funds to the creditor only in the event of the obligor's default (i.e. a similarity to a guarantee or a credit default swap - CDS).</p> <p>However, in contrast to a syndicated loan or a common-type guarantee, the obligor under the loan contract is not a contracting party to the sub-participation agreement and even may not be aware of the existence of such agreement - this amounts to the so-called "silent sub-participation agreement". The contract with the obligor is concluded only by the creditor (the so-called lead bank), which grants a loan or a credit commitment, and only afterwards does the creditor transfer the risk from this transaction to the sub-participating institution.</p> <p>The sub-participant typically has an unsecured receivable towards the creditor with no rights in relation to the obligor. It assumes two credit risks: a risk in relation to the obligor under the loan contract and a risk arising from the receivable towards the obligor's creditor (the lead bank). The receivable towards the creditor is conditional upon payment by the obligor and in case the obligor does not fulfil its obligations the sub-participant is not entitled to getting back the funds which have been provided to the creditor and, subsequently, it is impossible to recognise the receivable as a credit risk mitigation technique for regulatory purposes. Therefore, the provisions of Annex 15 to Decree No. 123/2007 Coll. refer to receivables associated with sub-participation as an example of ineligible collateralisation by a receivable.</p>

	<p>However, a variety of forms of sub-participation may occur in practice. The concept can also be used in different contexts and with different meanings. In order to assess whether a given transaction is a sub-participation within the meaning of Decree No. 123/2007 Coll. it is necessary to focus primarily on the assessment on the economic substance of the transaction. The most qualified party to carry out such assessment is the liable entity participating in the transaction.</p>
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