

Veronica Montagna interviewed in “The Lending Landscape...” which appeared in Metropolitan Corporate Counsel

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Veronica H. Montagna

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*In some ways, the banking and commercial-lending industry is what it always was: lenders underwriting the credit-worthiness of prospective borrowers, generally, and of various projects, specifically, to ensure that loans are priced profitably and commensurate with risk. In other ways, the sector is changing, with increased regulation and unsettled market conditions, along with a shifting borrower base, not to mention new shooters on the lending side. **Veronica H. Montagna, a McCarter & English partner who represents banks and other lenders, and who will be a panelist at a banking law symposium in April, takes a look at the banking and lending landscapes and where they intersect with the law. Her remarks have been edited for length and style.***

MCC: What is the overall state of the banking and commercial-lending sector today?

Montagna: As to regulation, the fallout from Lehman’s collapse in 2008 and resulting legislation – Dodd-Frank, mostly – has been regulation and rulemaking by the Board of Governors of the Federal Reserve, the FDIC, the OCC and the SEC, among others, in the hundreds, and with more rules and regulations yet to come, that has put undue burden on lenders, such as community banks. They weren’t involved in the kinds of mortgage-backed securities products at the center of the fiscal crisis but are bearing, perhaps unfairly, the heightened regulation and, in many cases, are being forced to merge to remain viable. As to the lending climate, there is plenty of cash still on the sidelines looking to be deployed, but there remains a hesitancy among many lenders to deploy that capital, as they remain risk averse to the point of being timid, albeit understandably so. The traditional players in the lending game – the banks and the private equity firms – have been joined by nontraditional online-only lenders. That’s a relatively recent phenomenon that has grown explosively post-2008, certainly in the last five years.

MCC: Banks and other lenders make their money by ... lending. Outstanding loans are their assets, and cash on the sidelines is not. Why hasn’t the spigot opened more?

Montagna: Bigger, known-quantity, credit-worthy borrowers with good track records as to repayment, solid management and robust revenues can still borrow, and often at attractive rates and terms. It’s the fringe would-be borrowers – first timers, unknown

quantities and players in troubled industry sectors – that are paying higher rates and being offered less favorable terms, if they can get a loan at all. A lot of it is human nature – once burned, twice shy. And a lot of it, understandably, is about self-preservation and survival. Even the most institutional of lenders is composed of people, and nobody wants to be the person who approved the paper that went bad. There was a similar phenomenon post-Lehman, when lenders didn't foreclose in large numbers on borrowers when the loans were only semiperforming or nonperforming. Secured creditors who saw an opportunity for improvement in cash flow and value of collateral kicked the can rather than book the losses. And generally speaking, other than a small pool of lenders – sometimes found in commercial real estate – who are in the loan-to-own game, banks and commercial lenders prefer collecting the coupon, and ultimately the principal, to seizing the collateral.

MCC: Will that landscape change any time soon?

Montagna: If I knew that Part of the underwriting process is measuring the risk attached to any given industry sector. So today's flush sectors may be tomorrow's troubled sectors, and vice versa. Professionals who lend money for a living stay on top of those trends and are generally adept at reading market conditions and future prospects for would-be borrowers and entire sectors. On balance, the overarching national economy seems to be growing, albeit slowly, and that should create added demand for commercial debt. And in almost any economic climate, some borrowers are so desirable as customers and have so much leverage that banks will lend to them readily, and often without collateral.

MCC: Let's talk about regulation. Clearly, some is needed; just as clearly, onerous, burdensome regulation stifles lending activity. Which way is the wind blowing?

Montagna: It depends in part on which party, or parties, wins the White House and controls Congress. The Republicans have made significant noise about repealing or significantly amending Dodd-Frank, which gave rise to the heavy-handed regulating. If they run the table, it will be interesting to see whether they have the ability and the political will and capital to do it, or if it has been largely rhetoric. If the Democrats win the presidential election, I wouldn't expect any lessening of regulation, even if the Republicans control Congress; the president would have not only veto power but also effective control of the SEC and the Fed, where the rules are made. Meantime, banks and other lenders have to figure out how to remain profitable against the backdrop of political dysfunction in D.C. Parenthetically, the recent death of Justice Scalia creates even more uncertainty about the viability of the Affordable Care Act and potential challenges to it, and many companies – the borrower base – view Obamacare as a backbreaking mandate.

MCC: The Federal Reserve has indicated that it is looking to move rates gently upward. How will that affect the lending landscape?

Montagna: Rates are only one part of a loan. The terms under which the loan is made are hugely important. And when lenders are reticent, prospective borrowers generally will see a lot more in the way of negative covenants, financial covenants, reporting obligations, guarantees and more robust demands as to collateral.

MCC: You're on the panel that the Banking Law Section of the New Jersey State Bar Association has put together. What will that cover, and why now?

Montagna: The umbrella topic is the basics of banking and banking law. We'll cover a variety of nitty-gritty subtopics that, in the aggregate, make up the bulk of what attorneys who represent banks and other lenders handle and keep us employed: the basics of lending transactions terms sheets, loan agreements (which are the main documents in loan transactions), guaranties, security agreements (because the statutes require granting language to create a lien), Uniform Commercial Code considerations, and generally, how to make and perfect a lien. We might chant the lending mantra: "I hereby grant a security

interest in” We will also cover defaults, collections and workouts (commercial versus consumer) with references to the Fair Foreclosure Act and the limits of lender liability. We will delve into the deposit account relationships, the effects of electronic banking, the responsibilities of the customer and the bank, and the risks of loss assumed by both for fraud. Finally, we will include a discussion of the Truth in Lending and RESPA-integrated disclosure. Why are we holding this now? No matter the prevailing conditions or regulatory environment, banking and lending fuel the economy, so there’s ongoing interest.

MCC: Any interesting case law related to banks and lending?

Montagna: There’s a recent case that sent shivers up my spine and, I assume, the spines of many of my colleagues and counterparts, plus in-house banking attorneys. The law firm representing a lender inadvertently released liens on all assets, not the specific one that should have been released. The borrower, a significant company, went bankrupt. Needless to say, litigation ensued because the lender had no collateral. The lender lost; the court found, in essence, that a lender can’t just say, “Oops, we accidentally released the lien,” because the statute is clear as to how to perfect and release liens. Talk about a reminder that outside lawyers and in-house counsel have to be careful, especially when it comes to collateral, which is so important to lenders. You have to make sure at the time of the loan and throughout its life cycle to preserve that collateral.

MCC: So what will banks and banking look like 20 years from now?

Montagna: Banks need to be aware that their customers on both the consumer and commercial sides are changing and embrace the change. Younger people don’t bank how older people do or did, and they’ll expect banks to keep up with available technology. There will be less face-to-face contact and, on the consumer side, probably few, if any, bank branches to walk into. Routine banking transactions will be app-based and speedy – the way the future customer base will want it. And consumer loans will be commodities coming from virtual lenders. The collateral will be the house, and the rates will be what they are.

Because the younger crowd will also be owning and operating the businesses and serving in management roles, that will spill somewhat over to the commercial side, where things will be less personal. That might be a mistake because it helps underwriting risk when you really know the borrowers, their management, their track records – the whole package. You’ll still have access to the objective data, crunching the numbers, but the subjective, personal relationship counts. And the less you know about the borrower, the more you’ll want to protect the loans with robust, valuable collateral. Tomorrow’s bankers will need to be creative and offer legitimate, profitable banking products that appeal to their new customer base while not carrying inappropriate risk to the bank’s stockholders. And banking attorneys will probably play roles similar to those today, not the conscience of the banks but counselors as to what the law requires and guiding them accordingly.