

How to Use the Guide

Commercial lending represents the largest source of income for banks. As loan officers and their attorneys are well aware, lending and all issues relating to it can expose the lender to significant risks.

Risks emanate from two sources — the inherent and often unavoidable business risks that go with lending and the legal risks associated with not adequately protecting the bank's interests. Given the nature of the commercial lending process, the lender and his attorney must stand vigilant against both risks.

The legal questions are those for which most lenders are less prepared. The *Guide to Commercial Banking Law* has been developed to supply the lender and his attorney with information about the law of commercial lending in a practical and easy to understand fashion. Failure to protect the bank's interests adequately not only undermines the loan but also exposes the bank to unforeseen legal and financial risks.

From loan negotiation to commitment and loan documentation to monitoring outstanding credit, the guide provides the legal background lenders and their attorneys require. The guide has been written by a bank attorney whose daily responsibility is to advise loan officers on legal matters relating to their lending decisions.

The manual is organized in seven parts, along the same lines as the lending process. The seven parts of the guide include:

Part I	Concepts and Principles
Part II	Perfection and Priorities
Part III	The Role of Collateral
Part IV	Making the Loan
Part V	Monitoring the Loan
Part VI	Related Issues
Part VII	Bank Deposits and Collections and Commercial Paper

The first three parts present the lender with a broad discussion of the players, documents, and laws involved in a loan transaction — before the loan is made. The next two parts walk the lender through the steps involved in making a loan, closing a loan, and maintaining the health of a loan. Part VI covers such topics of importance as the privacy laws, environmental concerns, letters of credit, and bank deposits and collections. The last part covers the deposit and collection process, and commercial paper.

Chapters 1, 2, and 3 in Part I review the types of borrowers that lenders encounter and the types of loans available, and present an overview of the Uniform Commercial Code, which regulates lending. Borrowers can be individuals, corporations, partnerships, or combinations of each. Since many bank customers are corporations or partnerships, bankers and their counsel should be familiar with each entity and with precautions that should be taken when negotiating and making loans. Chapter 3, the “UCC Overview,” will clear up some of the confusion caused by the lack of uniformity among states’ commercial laws and the various revisions of the UCC, including the major revision to Article 9. Because the laws of each state vary, the discussions of the law in this chapter and other references throughout the book are by no means definitive. Rather, these discussions highlight the important times the lender should consult particular state laws.

Chapters 4 and 5 in Part II examine how to perfect a security interest in collateral and how to handle priorities when other creditors have an interest in the collateral. A lender and counsel should be aware of the rights of other parties that may affect the bank’s rights in relation to debtors and collateral, particularly the rights of competing creditors and the priorities with respect to different types of collateral.

Chapters 6 through 14A in Part III cover the most common kinds of collateral taken and the different methods of categorizing each type, and includes the newly added collateral categories sanctioned by the revisions to Article 9 of the UCC, such as health care receivables and commercial tort claims.

Chapter 14, “Real Estate as Collateral,” is an in-depth discussion provided to give the lender and counsel involved in real estate lending a broad understanding of the special rules and procedures that apply.

Part IV includes Chapters 15 through 20 and discusses the most effective ways to draft commitment letters and loan agreements and the consequences of using various clauses within them. Also discussed is the proper execution and documentation of these loan transactions. Chapter 18, “Loan Guaranties,” reviews guaranties and covers the defenses a guarantor may have that could prevent a lender from relying on the guaranty. Chapter 19 tells the lender what to expect if he is asked to participate in a loan as a lead lender or participant. Chapter 20 is a checklist for the lender, to be used to ensure that everything necessary to make a loan properly and prudently has been done.

Part V includes Chapters 21 through 23, “Loan Renewals,” “Loan Workout Strategies,” and “Lender Liability Issues,” respectively. Chapter 21 covers the collateral and documentation a lender may need for different types of loan renewals. Chapter 21A discusses monitoring issues during the course of a loan. Chapter 22 helps the lender and counsel understand the workout process with the aim of maximizing the bank’s recovery and minimizing its losses. Chapter 23 aids the lender and counsel in becoming familiar with the various theories of lender liability so they can recognize delicate situations when they occur and know how to proceed cautiously.

Chapters 24 through 29A in Part VI explore diverse issues of concern to the lender. Chapter 24 discusses the customer’s rights and the lender’s duties under the privacy laws, and the conditions under which a government agency is entitled to see a customer’s bank records. Chapter 25 warns lenders about the pitfalls of making loans to any business that might be violating environmental regulations. Chapter 26 defines the types of letters of credit, the parties to the credit, and the obligations of all parties under a letter of credit agreement. Chapter 27 provides guidelines for bankers to help them understand certain rules and regulations that affect their work. Chapter 28 familiarizes the banker with bankruptcy-related

issues, such as the warning signs which indicate that a bank customer is having financial problems. Chapter 29 discusses Regulation O and the insider rules, and how they affect any loans or extensions of credit from a bank to a person who is considered to be a bank insider.

Part VII discusses aspects of the deposit and collection process, and commercial paper, and includes Chapters 30 through 35. Chapter 30 provides definitions, rules, regulations all bank employees should understand. Chapter 31 discusses procedures for opening accounts, and the products and documents involved. Chapter 31A discusses bank deposits, safe deposit boxes, checks, and other items. Chapter 32 describes the different types of customers and accounts. Chapter 33 reviews problems that may arise in the check payment process. Chapter 34 analyzes the basic concepts of dealing with commercial paper. And Chapter 35 discusses various aspects of Regulation CC in relation to the check collection process and automated banking transactions.

REVISIONS TO ARTICLE 9 OF THE UCC

In 1990 a committee was established by the Permanent Editorial Board for the Uniform Commercial Code (UCC) to address Article 9 and propose revisions that would bring Article 9 more in line with the way banking business had developed. Changes in the way banking was done, changes in technology, and innovations in business practices all led to the same conclusion — certain aspects of Article 9 had become outmoded and needed an overhaul. Further, there are always ways to improve the UCC, and a drafting committee was charged with determining what improvements could be made.

This proposed overhaul was carefully addressed over a period of years. The drafting committee met repeatedly during the 1990s to make reports, solicit comments, address comments, and revamp earlier drafts. The final draft was presented in 1998 to the American Law Institute and the National Conference of Commissioners on Uniform State Laws and the final statute was approved in May 1998, becoming effective on July 1, 2000. Revised Article 9 has been adopted by state legislatures throughout the country.

The *Guide to Commercial Banking Law* provides a comprehensive discussion of all of the changes made by the revision so that when your state adopts the revisions, you will already know what to expect and how to proceed with your policies and procedures.

Highlights of Revised Article 9 include the following:

- The scope has been greatly expanded. There are different types of collateral and different categories and methods of perfection. For example, Revised Article 9 now covers rights to judgment proceeds, torts, and insurance proceeds. A new type of collateral, payment intangibles, is now included.
- Deposit accounts, previously excluded from Article 9 coverage, are now included.
- There are significant changes in the information that must be included in financing statements, and changes have even been made in who must sign.
- There are significant changes to the laws relating to purchase money security interest. The definition has even changed.

- There are a number of major changes to the rules regarding the perfection and priority of security interests.
- The choice of laws rules have been modified in a major fashion. For example, the location of the debtor for filing purposes has been changed.
- The filing system itself has been changed by the revision, and the filing system is simplified.
- Certain definitions have changed, such as “good faith” on the part of the lender, “proceeds,” “debtor,” and others, which will affect other sections of Article 9. Further, new definitions have been added.
- Interests in insurance proceeds are covered by the revision. Taking insurance agents’ commissions as collateral is now addressed.
- The identification and description of collateral have been revised.
- There are specific new guidelines on the duties of a secured party when disposing of collateral after default.
- Due to all of the changes in banking relating to securities, there is comprehensive treatment of investment property collateral.
- The perfection, priority, and enforcement of agricultural liens have changed dramatically.

Just about every aspect of Article 9 has been modified by the revisions. Other areas of law, such as real estate and consumer law, were also affected. The far-reaching nature of the revisions have had a major impact on every financial institution. Policies and procedures have been changed to address the changes in the UCC.

In order to do your job effectively in an ever-changing environment, the first rule of thumb is to know what is changing and then to make modifications accordingly in how you:

- Look at a loan proposal.
- Consider credit enhancements.
- Document the loan.
- Perfect your security interest.
- Monitor your collateral and loan position.