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No matter how experienced you are as a lender or how much of your customer's best interests motivated your actions; when a banking relationship runs into trouble the next two words you could easily hear are lender liability.

Good Banker or Lender Liability-
A Banking Conundrum?

I was prompted to write this article because of the reflections I had on my own training and career in banking contrasted with my experience as an expert witness in finance related cases. I was also thrilled to legitimately sneak in the word conundrum as the new buzz word in economic circles. Years from now, people will be able to date this article for using that word much like the buzz word of several years ago – gravitas. Nevertheless, I am concerned about the conundrum that exists between my training as a lender and my recent experience testifying as an expert witness in financial litigation.

I spent more than 30 years as a lender in commercial banks including over 20 years as a senior policy-making officer and turnaround specialist for troubled banks. In all the training I received and in the experiences I had, good judgment was a most valued ability. I have always worked in a decentralized lending environment where authority, analysis, judgment and responsibility were left to line lenders. After a long period of supervision and assessment of your skills, you were given authority to evaluate lending circumstances and make the decision on every type of loan situation; aggressive new loans, borderline customers and workouts. In fact, the loan administrations in which I worked insisted that the originating officer handle the workout if that circumstance should arise, in order to "learn from your mistakes."

A bank, like any of its customers, is organized to make a profit. It, therefore, requires sales which are usually generated, in large part, by the very same officers responsible for granting loans. Banking is the only industry where the Salesman and the Credit Manager are one and the same person. One of my old bosses told me that being a loan officer was like "a barrel tapped at both ends." The tap on one end is that you must provide intelligent loan decisions to establish and maintain the bank's loan relationships while the tap at the other end represents your duty to protect the bank's capital. Between those two tapped ends lies the conundrum.

There isn't a business in the world that hasn't run into difficulties at some point in its history. Sometimes difficulties arise from good things happening such as when sales growth outstrips working capital or problems can occur from not so good things like an unexpected supply shortage, rise or fall in market prices, etc. Sometimes the difficulties are just a "bump in the road" and sometimes they aren't. It's at these times that even the most experienced loan officer gets to really earn their pay; "Do I make the next advance or not?". Interestingly enough, whether you decide to support your customer or "pull the plug," you need to keep in mind two words – Lender Liability. Regardless of which way you decide to go, if things don't work out well, you may be hearing them all too soon.

As I said at the outset, what prompted me to write this article was the apparent conflict between my training (and I think I had great training) and the rising volume and sophistication of lender liability claims. Judging by the inquiries I get and recent cases I have been involved with, lender liability claims are skyrocketing in number and size.

Banks, bank counsel and other interested parties have tried mightily to limit this expansion. Many states have passed laws to limit lender liability claims. Loan documents frequently contain mandatory arbitration clauses and a waiver of jury trial and courts have tried to narrow lender/borrower disputes to within the "four corners" of the loan documentation. All to no avail. In the "old days" a borrower might say "you should have never lent me that much money because you knew I couldn't handle it." Now the claims involve Fraud, RICO, at least five kinds of negligence along with the milder old favorites of Breach of Contract and the Covenant of Good Faith and Fair Dealing. Having watched the process frequently and at very close range over the past few years yet firmly believing in the tremendous economic benefits for all concerned of a well-trained, intelligent loan officer; what is a banker to do? (Conundrum - A paradoxical, insoluble, or difficult problem; a dilemma)

There are three things to do:

Hopefully, you have been doing this all along; but certainly when a borrower hits that first bump in the road and you are called upon to make difficult decisions; DOCUMENT, DOCUMENT, DOCUMENT. Assuming there are no blatant facts to undermine your actions to this point, the first place an experienced opposing counsel will look is to the bank's policies and procedures searching for deviations between policy/procedure and actions. There are many other places they will look based upon the individual circumstances which are precluded here by space limitations. The key ingredient is that it's okay to deviate from policy so long as you follow proper procedures and DOCUMENT the valid business reasons for your actions.

Second, I strongly suggest you read an article entitled "THE TEN COMMANDMENTS FOR AVOIDING LENDER LIABILITY" By Helen Davis Chaitman. Paraphrasing Commandment Number 1 (and I don't believe it is a coincidence that this is the first commandment); "Thou Shall Take No Precipitous Action". I have seen an awful lot of situations where the bank could have eliminated litigation, perhaps resurrected the relationship and saved tremendous amounts of money by only living up to this commandment. By following the other 9 commandments as well, you stand a good chance of avoiding further, very substantial liability and litigation.

Thirdly, should you find yourself in a potential lender liability situation, call us (a shameless self-promotion). Seriously, an experienced, credible and totally independent third party to vouch for the bank's faithfulness to industry standards and practices can make the difference between recovery and loss.

(About the author: Mr. Fried is a principal in Capital Finance, a litigation consulting and support firm specializing in complex banking and commercial finance matters. He can be reached at (760) 776-5749 or Steven.Fried@BankingExpertWitness.com)
