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Issue 1, 2022

Welcome!

Welcome to our first *Promissory Notes* issue of 2022. We expect 2022 to be as interesting of a year as 2021 was for the banking and finance industry. We cover a variety of topics in this issue including predicted banking trends, banks and net-zero carbonization and non-investment in fossil fuels, the Supreme Court and bankruptcy fees, SBA direct lending, and the peak of ATMs.

Since we have been publishing *Promissory Notes* for a while now, we feel it is important to see what you think of the publication. At the end of this e-newsletter, you will find a survey. It should take just a few minutes and would help us tremendously. So please participate if you can.

As always, thank you for reading.

F. B. Webster Day, Chair, Banking & Finance Practice Group, and Co-Editor, *Promissory Notes*

and

Elizabeth A. Benedetto, Chair, Public & Project Finance Practice Group, and Co-Editor, *Promissory Notes*

"The safest way to double your money is to fold it over and put it in your pocket." – Kin Hubbard

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5 Banking Trends to Watch in 2022

"Some of the narratives Banking Dive sees taking shape for 2022 — crypto, for example — are carryovers from last year, reaching a logical conclusion or forward motion. Others, such as the office-return debate, may be at a pivot point."

Why this is important: Banking Dive lists the five banking trends it believes will be most important in 2022. They are: i) returning to the office; ii) regulatory changes, in general, and measuring "climate risk" (and possibly other ESG issues) in particular; iii) digital assets and cryptocurrencies (See here for a discussion of 300 community banks dipping into this arena); iv) M&A -- bank mergers seem to be

increasing slowly; and v) the possible approval of SAFE, the Safe Banking Act, under Democratic leadership and as opinions about lending for marijuana businesses in states where marijuana use now is legal. It is an interesting list and discussion. --- Hugh B. Wellons

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Supreme Court to Determine Constitutionality of Bankruptcy Fee Increase

"The issue, which stems from a 2017 law that hiked the government fees that most large companies in bankruptcy must pay, has divided top appellate courts across the country."

Why this is important: The U.S. Supreme Court granted certiorari this month in a case arising out of the Circuit City bankruptcy in Richmond, Virginia regarding certain additional fees imposed on large Chapter 11 debtors. The law's imposition of higher fees in most, but not all, U.S. bankruptcy courts has caused uncertainty over the legal status of over $300 million in fees imposed under the law, according to the U.S. Trustee's Office.

The underlying lawsuit claims the law violates the U.S. Constitution's Bankruptcy Clause, which requires bankruptcy laws to be uniform, because it hiked fees for Chapter 11 debtors in most states but failed to do the same for Alabama and North Carolina (which use the Bankruptcy Administrator program to perform similar duties as the U.S. Trustee in large corporate bankruptcies). The law was amended later to include Alabama and North Carolina. Various circuit courts of appeal have reached different conclusions on this issue. The 4th Circuit (where the Circuit City case arose) and the 5th Circuit have concluded the law is constitutional whereas the 2nd and 10th Circuits have found it to be unconstitutional. A decision may be reached by late June 2022. --- Bryce J. Hunter

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How Banks can Lead the Way on the Race Toward Net Zero and Make Decarbonization Banking Sense

"The establishment earlier this year of the industry-led, UN-convened, Net-Zero Banking Alliance bringing together 53 banks from 27 countries representing almost a quarter of global banking assets (over US$37 trillion), is the most vivid demonstration of this."

Why this is important: You should read this article, even though you've read many like it before. I feel a bit of a rant coming on; I must be getting old. I remember a day when banks owed their first duty to their depositors, to keep those deposits safe. Banks' next duty was to shareholders, to try to return that investment trust with a profit, and maybe even a dividend. Of course, surrounding all of this were myriad complicated bank rules that primarily were aimed at keeping banks out of financial and legal trouble. That was then; this is now.

Many years ago, Congress and bank regulators, in their infinite wisdom, began piling on banks myriad social justice responsibilities. First came ending redlining, which made sense. That was a horrible practice committed by many banks to keep minorities in certain areas of town and out of others. It always was a stupid practice that could have been shut down for inefficiency alone. No smart bank would have engaged in that. It was wrong and bad business. Later, regulators, gradually, began to expect bank management to reflect their communities, including gender and racial diversity. This was believed necessary to overcome inertia, the theory being that old white men tend to know, hang out with, and recommend other old white men. Hard to refute that! Banks still have a way to go in this effort, but it is better. Also, banks with more diverse leadership can see its community in new ways and become more effective. Next came CRA, or the Community Reinvestment Act, which scored banks on their "investment"/lending in economically depressed areas of their market. Forgetting for a moment that many rural, community banks operate in nothing but economically depressed communities, many banks do operate in markets where they can focus lending only in businesses that are likely to repay and security that will cover the amount of loan. This was "social justice," but it could be seen also in terms of supporting the community where each bank works. A more successful community, over time, should provide more opportunity for business and the bank.

Now, banks may be required to score a host of such issues. The SEC and others call it "ESG," for environmental, social and governance. Some politicians are pushing for the entire list, some are focused on one part or another. The largest push now seems to be measuring a bank's "risk," in part, relating to

how the bank "plans for" climate change, which the article addresses. All of ESG is not part of bank regulation--yet--but many institutional investors are being pressured to require ESG planning in the companies/banks those investors select. More and more, our government is being influenced to evaluate banks not on how well they "bank," but on how well they do a host of other things, meeting changing social norms that often have nothing to do with traditional banking. What's wrong with that? Well, some of this risk is real. Climate change is real, so how wise is an investment in property below sea level, for example? But how far do we take that? What about an established natural gas company? Don't we still need natural gas? Many of the specifics of ESG are societal goals not directly connected to business or lending. Do we really want to drive outcomes at the expense of businesses, including banks? As taxpayers and depositors, we financially support the FDIC insurance that guarantees these bank deposits. When we dilute banks' responsibilities, we put ourselves in more danger as taxpayers and as depositors. We also, through more regulation, impose more expense on banks, making banking more expensive for everyone. Two states are "solving" that problem by providing "banks" owned and operated by the state, aimed at serving the poor. The government trying to run a bank? That will go well! (See the article below: "House Republicans blast prospect of SBA direct lending.") **---** Hugh B. Wellons

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West Virginia Lawmakers Target Banks that Boycott Fossil Fuels

"On the heels of the state's top banker taking action against an investment group pulling its funding from fossil fuel industries, a legislative committee took further actions against banks and investment firms."

Why this is important: After West Virginia State Treasurer Riley Moore and treasurers from 15 other states put the banking industry on notice in late November that they may pull state deposits from financial institutions that implement investment policies that boycott doing business with fossil fuel energy companies, the Legislature is considering a bill that will restrict the State of West Virginia from entering into contracts with any bank or investment group that refuses to deal with, or terminates existing contracts with, or takes other actions intended to penalize, inflict economic harm on, or limit commercial relations with, any fossil fuel company. The bill, Senate Bill 262, was reported out of the Senate Finance Committee, and is at the time of publication of *Promissory Notes*, making its way through the full West Virginia Senate for passage, before heading to the House. If passed, the legislation will allow the Treasurer's Office to disqualify financial institutions from the competitive bidding process for state contracts and require the Treasurer to post a list of restricted financial institutions on his website, possibly affecting approximately $18 billion of state funds currently managed by the Treasurer's Office. Senate Bill 262, and similar legislation in other states, has being introduced to try to combat against the growing movement among financial institutions and investment funds to adopt so-called ESG policies that consider environmental, social and governance criteria in making investment decisions, leading to a divestment from fossil fuels, which directly affects states that are dependent on fossil fuels. In energy-dependent states like West Virginia, banks and investment funds should be aware that those states are looking to cut ties with organizations that are making ESG-driven decisions to the detriment of the fossil fuel industry. **---** Elizabeth A. Benedetto

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ATMs May have Peaked in 2019, Research Finds

"The banking strategy pivot comes as digital banking and payment alternatives become more widespread."

Why this is important: Consumers' use of ATMs is expected to gradually diminish over the next decade as younger generations gravitate to digital platforms and cashless and contactless alternatives. According to McKinsey's third-quarter U.S. Payments Map report for 2021, the rate of decline of ATM use will be about 6 percent annually through at least 2025. The decreased demand for cash is making ATMs more expensive to maintain. Some banks are sharing ATMs, while others are outsourcing their servicing to "specialized cash-in-transit players." Banks looking to appeal to the younger generation should focus on investing in digital tools, such as digital wallets with embedded credit cards, prepaid debit cards and automated clearing house transfers. Yet brick and mortar banking facilities and cash as a form of payment will remain important to parts of the population that don't have access to digital alternatives. --- Brienne T. Marco

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House Republicans Blast Prospect of SBA Direct Lending

"The Biden administration has proposed that the SBA be given the authority to make direct loans of $150,000 or less."

Why this is important: The article discusses a Biden proposal to allow the SBA to make direct loans less than $150,000. The SBA, or Small Business Administration, provides a number of federally sponsored programs to help small businesses. SBA loans provide potential credit to many small businesses that otherwise might not qualify for operating funds. Currently, these loans are approved and underwritten (up to 85 percent) by the SBA, but made by banks. Part of the theory is that the local bank can assess the risk with a little more knowledge than the SBA, because i) they are closer to it, and ii) this is what they do. Also, they are better equipped to follow the progress of the loan. This article uses recent PPP loan fraud to demonstrate why, even when well-meant, this proposal may not be a good idea. I could provide a few other examples where the U.S. "loaning" money could best be illustrated with a loud flushing sound. Both skillset and politics make the U.S. government an historically inefficient lender. --- Hugh B. Wellons

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