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CAINS

Enforcement of lending beyond COVID-19.

The last year has seen many financial institutions implement a period of 'moratorium' in respect of the enforcement of lending in default. Instead, and alongside Isle of Man Government financial schemes, support has been, and continues to be, provided to customers on the Island facing unprecedented financial difficulties as a result of the COVID-19 pandemic.

It is far too early to think that we will soon be "beyond COVID-19", despite the Isle of Man's "virtual eradication of COVID-19" and lenders will likely continue for some time to be conscious of the impact of the pandemic on their borrowers.

However, as economies recover and balance sheets need bolstering the reality is that the moratorium on recoveries cannot continue indefinitely.

Lenders will need to consider the particular circumstances of each case. There will likely be cases where, despite the best efforts of both the lender and customer, any attempts to rescue the defaulting position during this period will have been unsuccessful.

In light of this, financial institutions would be well-advised to use this time to ensure that, following the disruption caused by the height of the pandemic on the Island, their records are in order such that both lenders and customers are clear as to the terms of any agreements that have been reached in light of COVID-19 which would form the basis for any justified recovery action.

This article identifies five considerations for banks and financial lenders in light of the COVID-19 pandemic:

1. Consider whether any events of default have occurred permitting the lending to be called in;
2. Review the communications on customers' file to determine whether any communications have resulted in rights to enforce any events of default being waived or variations to the lending terms being agreed. It is anticipated that during the height of the pandemic, lenders will have had an un-precedented number of engagements with customers seeking extensions of time to make repayments or increases to their lending;
3. Consider whether legal action is, at this time, the most appropriate course;
4. Consider reserving any rights to enforce events of default; and
5. Review the validity and enforceability of any security held.

Terms of the lending.

One of the first steps for a lender considering whether or not to call in a loan, will be to establish whether the loan agreement has been breached such that, in accordance with its terms, a demand for immediate payment in full can be made. In light of any previous forbearance that may have been provided as a consequence of the pandemic, lenders should be sure to confirm that any contractual event of default has not been (or is not) waived unintentionally.

It is anticipated that during the height of the pandemic, relationship managers and other personnel will have had an un-precedented number of engagements with customers seeking extensions of time to make their repayments or increased lending. Such communications, whether by email, letter, telephone or meeting may have resulted in a lender waiving its rights to enforce an event of default that had already occurred, or in the lender entering into an implied variation of the lending agreement with the customer even if a formal amendment agreement has not been signed.

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The decision to call in the loan.

Once it has been determined that an event of default has occurred, the event of default has not been waived and the loan can be called in, a lender should then consider if it is commercially and economically appropriate to do so. The fact that a lender may have the legal right to advance a recovery action does not necessarily mean that it is yet advisable to do so. In the film "Jurassic Park", the character of Dr Ian Malcolm played by Jeff Goldblum, criticises the genetic re-creation of the dinosaurs by stating that "your scientists were so preoccupied with whether or not they could, they didn't stop to think if they should". Whilst almost 100% of that film is entirely irrelevant to the issues in this article, as lenders look to begin recovery actions again, there are a number of factors that they should consider before acting.

The nature of the facility that is in place, coupled with the circumstances of the default in question, are both key considerations before progressing a claim for the recovery of any outstanding monies. Certain commercial borrowers for example may be able to trade out of any default and to make good, with interest, on the defaults made. Residential mortgagees in turn may be looking, in the "sellers' market" at the time of writing, to sell their home voluntarily and pay their existing mortgage outright.

However, formal action is sometimes the only avenue available to lenders, notwithstanding the concessions made during the height of COVID-19.

Reserving rights, waiver letters and amendment agreements.

In the period whilst a lender is considering whether or not to enforce their rights as a result of an event of default, it is usually advisable for the lender to issue a reservation of rights letter. The benefit of this is that such a letter highlights the default in question and reserves the lender's rights in respect of that particular event of default whilst the lender takes the time to consider its position. The intention is to avoid the customer being able to argue at a later date that the event of default was waived.

Care still needs to be taken here, particularly as COVID-19 may mean that a lender receives increased levels of correspondence and communications from customers. Even if a reservation of rights letter has been issued, a lender can be deemed to have waived its rights in respect of that event of default if the lender does anything that is contrary to the reservation of rights.

For example, if the customer speaks to the relationship manager each month stating that they will be late in making the outstanding monthly payments but they hope to be able to pay by a certain date, the lender's response to those approaches by the customer will be critical in determining whether it will be found to have, in effect, agreed additional time for the customer to pay by allowing time to lapse.

If, for whatever the reasons, the lender determines that it is not appropriate to call in the loan at that time, the lender should consider agreeing a formal amendment letter. This documented approach can assist going forward in avoiding disagreements between the parties as to what has been agreed and permitted as result of conversations or communications that may have occurred.

Secured property.

Another matter that the lender should take the time to reconsider in light of the effects of COVID-19 is the value and enforceability of its security. It may be appropriate to obtain an up to date valuation of the property (even if this is, in the case of real estate, simply a "drive by" valuation) and at the same time obtain a security review from an advocate. The value of the secured property is of paramount consideration to the amount of costs and effort that a lender may be willing to expend on recovering a debt.

Conclusion.

Whilst lenders will continue to work with and assist customers to deal with the ongoing difficulties caused by COVID-19 for some time, there will be cases where it will be appropriate to take action to recover outstanding borrowing. Lenders will have to balance the provision of reasonable concessions related to the pandemic against the reasonable enforcement of their rights against a defaulting borrower.

Lenders may find it beneficial to review and to ensure that its books and records relating to defaulting borrowers are in order following the disruption caused by COVID-19. Faced with defaulting borrowers it is incumbent upon the lender to clearly evidence the basis for any claim in order to counter-act any allegation of inequitable or premature actions against a defaulting borrower.

For more information please contact

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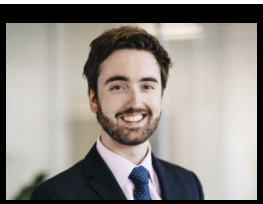

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