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Interagency Statement Encourages Lenders and Borrowers to Proactively Enter into Short Term Loan Modifications

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A late March 2020 Interagency Statement (the "Interagency Statement") encourages both lenders and borrowers to be proactive and not wait until borrowers experience the full economic impact of the COVID-19 pandemic before working together to effect short term loan modifications. The Interagency Statement, issued on March 22, 2020, is entitled "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by Coronavirus."

Lenders have greater latitude to enter into loan modifications that are not accounted for as troubled debt restructurings. The Interagency Statement provides that, generally, a loan modification does not constitute a troubled debt restructuring if such loan modification is:

1. made with respect to a borrower that is current on existing loans;
2. provides short-term relief; and
3. made in good faith in response to COVID-19.

Current on Existing Loans. This factor is most important with respect to timing. The borrower must be less than 30 days past due on regularly scheduled payments. It is in both the lenders' and borrowers' best interests to make necessary loan modifications before borrowers are no longer current on existing loans.

Short Term. The Interagency Statement does not provide much guidance regarding what constitutes "short term" for purposes of a loan modification. The Interagency Statement provides as an example of "short term" a 6 month payment deferral. However, as noted in a footnote to the Interagency Statement, any such payment deferral must be "insignificant," which determination may include whether the amount being deferred is insignificant relative to the outstanding principal amount or collateral value and whether any deferral period is insignificant relative to the payment frequency or maturity date.

Made in Good Faith in Response to COVID-19. The borrower must be experiencing short-term financial difficulties as a consequence of the COVID-19 pandemic.

One of the more important aspects of the Interagency Statement is to encourage lenders to establish loan modification programs (as opposed to loan modifications entered into on a case by case basis). The Interagency Statement provides that if a loan modification program is designed to provide short-term relief to borrowers adversely affected by the COVID-19 pandemic, any borrower that is current on existing loans will not be considered financially distressed. Accordingly, any loan modification with a borrower current on existing loans and made pursuant to such loan modification program will not constitute a troubled debt restructuring.

Regardless of whether lender or borrower, if you anticipate the need for a loan modification as a result of the COVID-19 pandemic, now is the time to begin discussions.
