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Lender Liability: An Expected Post-Coronavirus Legacy?

Banks and their lawyers know that lender liability cases come in all shapes and sizes. One of the common elements, however, is that many of those claims are asserted by financially distressed borrowers. No one is going out on a limb to predict that there will be many distressed borrowers in the months ahead as the impacts of the coronavirus are felt throughout the economy. Compounding this formula for increased lender liability risks are the new work restrictions on banking operations, the increasing complexity of banking and the simple fact that bankers are busier than ever.

What should Bank Leadership do to Avoid Lender Liability?

- **Study your workout team.** Over the past years, many workout departments were not prioritized and many seasoned officers (those who lived through past crises) have retired. Evaluate your talent and procedures.
- **Put a second set of eyes on all troubled credits.** The person who originated the loan may not be the best person to evaluate workout options.
- **Encourage your team to candidly communicate with distressed borrowers.** The expectation is that loans will be performed as written. But when that is not possible, banks are better served by borrowers who openly and fully share their circumstances so that all reasonable alternatives can be examined.
- **Document conversations.** Remind busy lenders that documenting conversations and careful communications remain important parts of their work.
- **Remind borrowers that the bank is the lender.** It is important that your borrowers grasp the basic concept that the bank is the lender. Their "banker" (loan relationship manager) may be a friend, but only the bank can decide

whether to amend the loan's terms or waive a condition.

- **Borrowers must be reminded that no promise or statement is binding upon the bank until it is in writing and signed by both sides.**
- **Be careful when offering words of encouragement.** Bankers naturally want to be positive and helpful, but a distressed borrower can misconstrue words of encouragement into an oral promise. Desperate people hear what they want to hear.
- **If there is a past course of dealing which is troubling, fix it the right way.**
- **Keep your workout files clean.** Original lending documents and collateral files/filings must be reviewed for content and completeness. Keep internal communications professional. Resist any temptation to blame a past officer for supposed malfeasance. Never write something that you would not want shared at church on Sunday.
- **Distinguish the material from the immaterial.** Focus on loan covenants that materially impair the prospect for repayment. The standard should be whether you would feel comfortable in explaining to a jury why this event of default is serious, especially respecting distressed borrowers who appear to be acting in good faith.
- **Be objective and fair.** A loan modification/forbearance/extension/workout is an exercise of avoiding greater harm to the bank. This is not a time to deal sharply with permitted late fees, for example.
- **Pre-negotiation agreements.** Once you decide that a workout is necessary, a proper pre-negotiation agreement will work best to protect the bank. As the legal landscape has shifted since the last crises, the benefits they afford lenders must be taken very seriously, especially for all complex workout projects.
- **When lender liability concerns arise, make sure your response team is a good fit.** Lender liability is both science and art. Many of the largest lender liability judgments resulted from counterclaims brought in a collection lawsuit that the bank filed. Recognize early that your normal collection law firm

may not be the right group to defend a lender liability lawsuit or counterclaim.

Lender liability risks may be increasing in the future. Putting the right team together and then working to head off potential lender liability claims as early as possible is now more important than ever. For additional information, please contact any attorney in Frost Brown Todd's [Financial Services](#) industry team.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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