THE CAYMAN ISLANDS
LAW REFORM COMMISSION

The Enforcement Of Mortgage-type Security Over Real Estate: Is Reform Of The Law Necessary?

Discussion Paper

23rd November, 2018

THE CAYMAN ISLANDS LAW REFORM COMMISSION

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1. INTRODUCTION

BACKGROUND

1.1 This Discussion Paper is prepared in response to a referral by the Honourable Attorney General, dated 30th January, 2018, requesting that the Law Reform Commission (the **Commission**) review and consider whether it is necessary to reform the law relating to the enforcement of mortgage-type security over land and, in particular, over residential properties. The request followed a heightened level of public comment, and concern, regarding the number of such procedures, colloquially referred to as '*foreclosures*', in the recent past. The dominant theme of the public commentary has been the level of hardship, it is claimed, that has been experienced by the owners of residential property, who have been affected by these procedures. These concerns were echoed by Members in the Legislative Assembly and prompted the Minister of Financial Services and Home Affairs to request, through the Honourable Attorney General, that the Law Reform Commission conduct a comprehensive legislative review of the mortgage framework in the Cayman Islands.

1.2 There has been no shortage of statements in the public media to the effect that the number of residential '*foreclosures*' is inordinately high, and increasing. The following are examples:

(1) *"Mortgage defaults remain high:*

> *Banks call on borrowers in difficulty to engage early on. Since the financial crisis, mortgage defaults have been a growing issue for borrowers and lenders. Exact data is difficult to come by but demand notices published by banks in the Cayman Islands Gazettes show more people are finding it harder to make their mortgage payments."*[1]

[1] https://www.caymancompass.com/2014/01/06/mortgage-defaults-remain-high/.

(2) *"Home repossessions up by over 34%:*

Local banks repossessed 22 homes, amounting to $4.2 million, in the third quarter of 2015, which the economic and Statistics Office said was "significantly higher" than just three foreclosures in the same quarter of 2014, amounting to just $338,000. According to the latest official economics report, at the end of October last year, 148 properties, amounting to US$35.1 million, were in the process of being foreclosed, which was 34.6% higher than the previous year."[2]

(3) *"Speedy foreclosures rob owners of equity:*

A group of concerned citizens, many of whom have lost their homes, have come together to raise awareness of what they see as a collusion between realtors, valuers and banks over speedy foreclosures that rob owners of tens of thousands of dollars in equity after just three months of arrears. Members told CNS that as many as 3,000 local properties have been taken by banks in the last three years, but given the shocking speed and ruthless way homes are being auctioned to cover loans with no regard for house values, they say government must now intervene."[3]

(4) *"Dramatic spike in foreclosures:*

The number of people losing their homes to foreclosures has almost quadrupled in the last five years. There were 116 forced sales in 2015 according to data from the Cayman Islands Real Estate Brokers Association's multi-listing (sic) system. That compares to just 30 in 2011. Realtors say the dramatic jump suggests a more aggressive approach from banks dealing with bad debts in the past two years."[4]

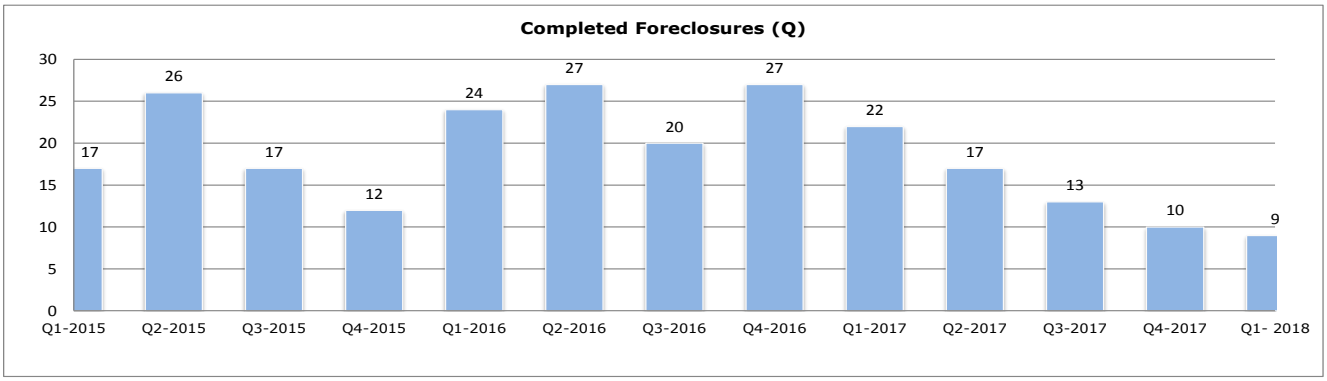
(5) *"Rivers points to foreclosure conflicts:*

The financial services minister denied that government is ignoring the issue of banks foreclosing on people's home loans and the excessive fees that some of the institutions are charging customers, as she said that she has already met with the bankers association about the issues. [Minister] *Tara Rivers said that all the fees charged by banks are now*

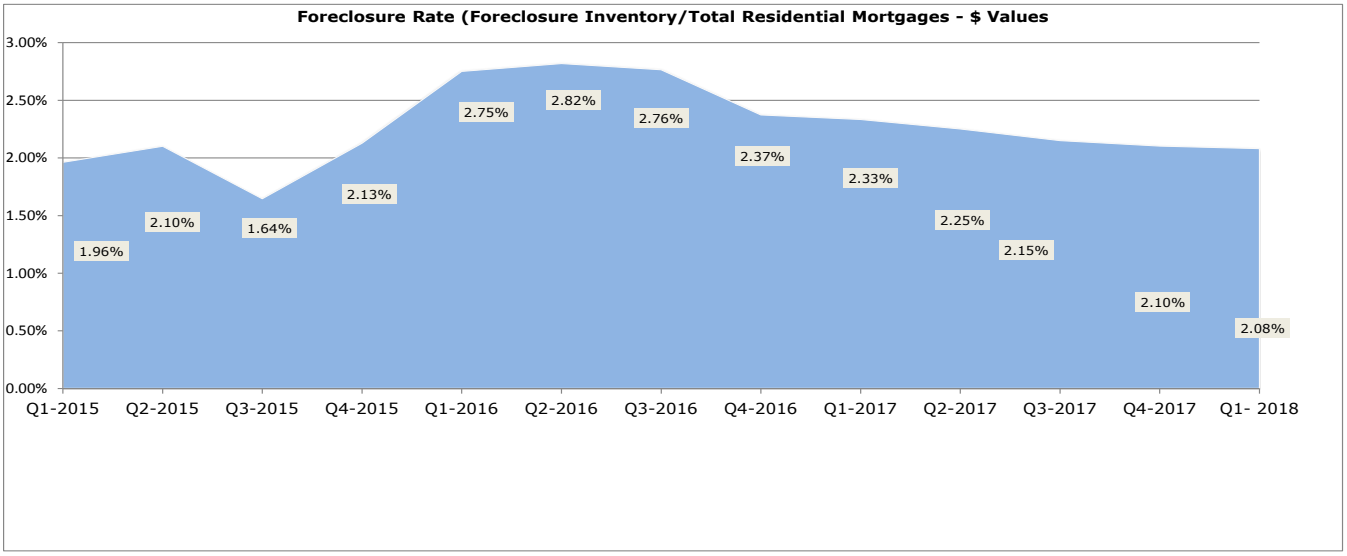
[2] https://caymannewsservice.com/2016/02/home-repossession-up-by-over-34/.
[3] https://caymannewsservice.com/2015/07/speedy-foreclosures-rob-owners-of-equity.
[4] https://www.caymancompass.com/2016/02/02/dramatic-spike-in foreclosures/.

on the CIMA website, bringing transparency and customer power to the issue. But she pointed to a lot more challenges surrounding the problem of foreclosures. "Banks lend for profit," the minister told the Legislative Assembly Monday, and they have "a legitimate expectation" to get it back. Over the last few years the previous PPM administration has been widely criticised for not acting to protect people's homes. Government has been accused of downplaying the problem and the numbers of people impacted. They were also criticised for pointing an accusatory finger at the borrowers for failing to manage their cash rather than the lenders for wanting to pull the loan deals and get their money back within a short period of default, regardless of the circumstances of the borrower."[5]

1.3 It may be entirely coincidental that the most recent of the above extracts, other than the quoted statement from the Minister, is dated as far back as 2nd February, 2016. In fact, the official statistics produced by the Cayman Islands Monetary Authority (**CIMA**) show a significant, and steady, decrease in both the number of completed residential '*foreclosures*' and rate of such procedures, relative to the total value of residential mortgages, from the second quarter of 2016 to the first quarter of 2018. See the CIMA produced statistical tables shown below.



[5] https://caymannewsservice.com/2017/11/rivers-points-to-foreclosure-conflicts.



1.4 The tables show that these procedures have decreased from a high in Q2-2016 of 27 such completed procedures, representing 2.82% of the total value of residential mortgages, to 9 completed procedures, representing 2.00% of total value, in Q1-2018. The Commission has not examined whether there is a precise causative correlation, but it is a matter of public record that there has been, in general, an improvement in the local economy within the period covered by the CIMA '*foreclosure*' statistics.

RESPONSE OF THE COMMERCIAL BANKS

1.5 Unsurprisingly, the expressed sentiments as to the conduct of commercial banks are not shared by the banks. The Cayman Islands Bankers' Association, whose website states that its membership comprises the majority of registered Cayman Islands banks and trust companies, has published a code of conduct governing its members, referred to as The Banking Code (the **Code**).[6]

1.6 Section 14 of the Code addresses how the CIBA's members deal with situations where their customers are in financial difficulty. Section 14.1 states:

> *"If you find yourself in financial difficulties, you should let us know as soon as possible. We will do all we can to help you to overcome your difficulties. With your cooperation, we may be able to develop a plan with you for dealing with your financial difficulties and we will fully document it with you."*

[6] A copy of the Code may be found at: https://www.cibankers.org/uploads/Banking-Code-V20152.pdf.

1.7 Sections 14.7 and 14.8 specifically address the issue of the banks' approach to the enforcement of security over real property:

> *"14.7 Repossessions*
>
> *Where your loan/mortgage is in arrears your lender will only commence legal proceedings for repossession of the property, where your lender has made every reasonable effort to agree an alternative arrangement with you or your nominate representative.*
>
> *14.8 Property Sale*
>
> *Where a lender has disposed of property which it has repossessed, the lender will notify the borrower of the following information and his/her liability for:*
>
> *(a) the balance of outstanding debt, if any;*
>
> *(b) details and amount of any costs arising from the disposal which have been added to the mortgage loan account; and*
>
> *(c) the interest rate to be charged on the remaining balance, if any.*
>
> *In circumstances where we pass your debt to another organisation for either sale or debt collection, we will always choose reputable firms. When property valuations are required, we will only choose reputable firms. No repossessed property will be disposed of by your bank through the direct sale to any employee, relative or close associate of an employee."*

1.8 Some of the comments published in the news media suggest that there may be instances where the banks are not following the Code. No doubt the consultation process which will follow the publication of this Discussion Paper should elicit the banks' response to this allegation. The Code is however entirely voluntary, and non-compliance with the Code gives rise to no legal recourse, unless that non-compliance also involves a breach of the law.

SCOPE OF THE DISCUSSION PAPER

1.9 The statement in the Cayman News Service article that the government *'has been widely criticised for not acting to protect people's homes'* hints at two potential solutions: either that the government should do more to ensure that there is greater protection in the law for

the interests of borrowers; or, the government should do more to ensure that the existing protections under the law are enforced.

1.10 The first issue properly falls for consideration by the Commission. As for the second, the relationship between secured lenders and borrowers has always fallen within the realm of private, rather than public law. The security created by what is traditionally referred to as a mortgage is the result of a private contractual arrangement between the secured lender and the borrower. In most legal systems around the world the extent of intervention by a government is to provide a legislative framework for the establishment and enforcement of these contractual rights.

1.11 Whatever the protections in the law for the interests of borrowers, most legal systems will leave it to borrowers to enforce their rights. In the process, the law will never lose sight of the rights of lenders who have a legitimate commercial objective to make a profit, or to avoid loss, from the transaction with the borrower. Commercial banks will also have the added obligation to protect the deposits of other customers, which deposits are the main source of the funds which finance secured loans.

1.12 The purpose of this Discussion Paper is to examine the existing law to consider whether in its current state it strikes the best balance between the interests of lenders and borrowers. In so doing, it would be naïve to assume that the respective bargaining powers of lender and borrower, either at the creation of the obligation, or the enforcement of the security, are equal. Most evidently, borrowers faced with an enforcement sale of their residence will hardly have the financial means to enforce their legal rights. This Discussion Paper will therefore examine whether there are means by which the burden of protection of borrowers' rights might be lessened.

1.13 This Discussion Paper will further examine whether the desired objectives may be achieved simply by amending existing laws, or whether the most effective method of reform is to enact new primary or secondary legislation. The Commission will consider whether there should be legislation which deals specifically with security over residential property, unlike the existing legislation which makes no distinction between security registered over residential properties, and that registered over properties used for other purposes.

QUESTIONS FOR CONSULTATION

1.14 Based on the review and consideration of the current status of the law and the areas of concerns raised by various observers, the Commission has identified a number of possible areas and approaches to reform. The Commission will not, in this Discussion Paper seek to make specific recommendations, but rather, to raise questions which may be considered during the consultation process which follows the publication of this Discussion Paper. The main questions are as follows:

(1) Should there be new and separate legislation specifically dealing with the enforcement of mortgage security over residential property?

(2) If there should be new legislation, should it be comprehensive legislation adopting the principles prescribed under the EU Directives relating to residential immovable property dated February 2014, and discussed at section 3 below of this Discussion Paper?

(3) Alternatively, should specific provisions regulating the service and enforcement of notices of the exercise of a lender's statutory enforcement powers in respect of residential property be incorporated in broader consumer protection legislation?

(4) Should all contemplated reform be effected by amending the Registered Land Law (2018 Revision) (**RLL**)?

Amendments to the Registered Land Law

1.15 If amendments to the RLL are considered to be the most appropriate method of reform should the following areas be considered for amendment?:

(1) Should the RLL make a distinction between the procedures to be adopted with respect to residential property as opposed to property used for other purposes?

(2) Should there be a reintroduction of the power of foreclosure whereby, pursuant to a court application, title to the charged property is transferred to the secured lender, but with the consequence that the obligations of the borrower are totally extinguished?

(3) Should there be an express power in section 75 of the RLL, or its equivalent, permitting a secured lender to sell the charged property by private contract, as well as by public auction?

(4) Should the RLL specifically define what constitutes a '*public auction*' and prescribe minimum mandatory requirements for a sale to be considered a public auction within the meaning of the Law?

(5) Should there be a codification of specific minimum steps a secured lender should take in order to demonstrate that it has acted in good faith in the exercise of its power of sale?

(6) Should there be a specific statutory prohibition against a lender selling the charged property to a party connected to itself?

(7) Should there be an express statutory prohibition against a pre-payment penalty for early redemption of a charge?

(8) Should there be a repeal of section 77 of the RLL, which allows the parties, in the terms of the charge, to amend the provisions of the RLL, specifically relating to the required period of default and the duration of a notice under section 72 (the **section 72 notice**)?

(9) Should there be provisions for the creation of fixed term charges over residential property, pursuant to which the lender may not require the borrower to repay the entire loan '*on demand*' in the event of a single breach?

(10) Should there be a limit to the amount of expenses for which the borrower may be liable upon the enforcement of a power of sale?

The Section 72 Notice

1.16 Should any of the following amendments or new provisions be adopted regarding the section 72 notice?:

(1) Should there be a prescribed form specifying the required contents of the notice, including the specific amounts outstanding, and the steps which the borrower should take to remedy the default?

(2) Should the section 72 notice be limited only to defaults in the payment of principal and interest and the defaults in keeping the property insured?

(3) Should there be a longer or shorter period of default which triggers a section 72 notice than that provided for at present?

(4) Should there be a longer or shorter period within which the borrower is required to remedy the default than that provided for at present?

(5) Should there be a prescribed pre-action protocol which should be followed by lenders who seek to enforce their security over residential property, to replace the voluntary Code of Conduct for Bankers, and which is to be taken into consideration by the courts to determine whether the lender has acted in good faith in exercising its security?

(6) Should there be a specific requirement that the secured lender serve all interested parties, such as, prior and subsequent chargees, and any person who has registered a caution against the charged property?

(7) Should there be an adoption of more modern modes of service which are more likely to bring the notice to the attention of the borrower?

2. DISCUSSION OF THE EXISTING LAW

2.1 At common law, a mortgage over land was created by a transfer of the legal or equitable title to land owned by a borrower (or mortgagor) to a lender (or mortgagee) as security for a loan or other credit advanced by the lender. The lender became the legal owner of the land, with the borrower retaining the equitable right to redeem or recover the land upon repayment of the loan or satisfaction of the liability.[7] A common law mortgage was created by a conveyance of the title to the land by the mortgagor to the mortgagee

[7] See Megarry & Wade, *The Law of Real Property*, 8th edition, para. 24-001.

or, in some instances, the delivery to the mortgagee of the title deeds, without which the mortgagor would have no proof of title to enable him to sell the land.

2.2 Under a common law mortgage therefore, the mortgagee was regarded as the legal owner of the land, and the mortgagor, by virtue of the right to redeem, referred to as the equity of redemption, was regarded as the equitable owner. The mortgagee was however obliged, usually by a term expressed in the mortgage deed, to re-convey title to the mortgagor upon repayment of the debt.

2.3 Under a common law mortgage, the lender (or mortgagee), as legal owner of the land, was entitled to possession, to the exclusion of the borrower (the mortgagor). This was one of the main remedies available to a mortgagee in the event of default by the mortgagor.[8] Another remedy was the right of foreclosure, properly so called. In law, foreclosure is a process by which the court would declare that the mortgagor's right of redemption extinguished, whereby the mortgagee became the legal and equitable owner of the land. As later discussed in this Discussion Paper, foreclosure, properly defined, is not at present permitted under Cayman Islands law.

(a) Statutory Intervention

2.4 The common law was modified in England by the Law of Property Act, 1925, the main effect of which was that upon creation of a mortgage, both the legal and equitable title to the land remained vested in the mortgagor. The current position in the Cayman Islands has been derived from a codification of the common law with adaptations based in part on the English Law of Property Act, incorporated in a statutory regime based on the Torrens system of registration of titles derived from Australia.[9] An understanding of the Cayman Islands legislative regime is essential to an understanding of the process for the enforcement of any security registered over land.

(b) The Registered Land Law (2018 Revision)

2.5 Acting pursuant to the Land Adjudication Law (Law 20 of 1971), the Cayman Islands government initiated a process aimed at the adjudication and registration of all parcels

[8] *Four Maids Ltd v Dudley Marshall (Properties)* [1957] Ch 317 (Ch D); *Ropauigealach v Barclays Bank plc* [2000] QB 263.
[9] For a history of the origins of the Torrens system see, *The Torrens System in Australia* by Douglas J. Whalen, The Law Book Company Limited, 1982.

of land within the Cayman Islands. Consequent upon this process, the RLL was enacted in 1971 to govern registered land in the Cayman Islands.

2.6 The RLL constitutes a comprehensive legal code governing registered land in the Cayman Islands, which, for all intents and purposes, is all the land within the Islands. As such, all legal questions relating to land law in the Cayman Islands are to be determined by interpretation and application of the RLL, and the subsidiary legislation and rules made pursuant to the RLL, and not by resort to the principles of common law in existence prior to the enactment of the RLL.[10] This principle is underpinned by two key provisions of the RLL: namely, section 3 and section 37(1).

2.7 Section 3 provides:

> '*Except as otherwise provided by this Law, no other law and no practice or procedure relating to land shall apply to land registered under this Law so far as it is inconsistent with this Law.*
>
> *Provided that, except where a contrary intention appears, nothing in this Law shall be construed as permitting any dealing which is forbidden by express provisions of any other law or as overriding any other law requiring the consent or approval of any authority to any dealing.*'

2.8 Section 37(1) provides:

> '*No land, lease or charge registered under this Law shall be capable of being disposed of except in accordance with this Law, and every attempt to dispose of such land, lease or charge otherwise than in accordance with this Law shall be ineffectual to create, extinguish, transfer, vary or affect any estate, right or interest in the land, lease or charge.*'

2.9 Any reform of the laws relating to the enforcement of security over land necessarily starts with examining the nature and scope of the powers which exist pursuant to the provisions of the RLL.

(c) A Charge Under the Registered Land Law

2.10 Under the RLL, the common law concept of a mortgage has been abolished. A security over land is created by registering in the land register for the parcel of land which

[10] See: *Paradise Manor Limited (in liquidation) and others v Bank of Nova Scotia* 1985 CILR 437; *Mums Incorporated and Thiam-Hong Tan v Cayman Capital Trust Company, B.V. (and others)* [2000 CILR 131, at p134.

comprises the security, a charge in the form prescribed pursuant to the RLL. The owner of the charged land (or, for ease of reference, the **borrower**) is referred to as the chargor, and the security holder (or the **lender**) is known as the chargee. There is no transfer of title, as a common law mortgage. The borrower remains the registered owner of the land. Upon satisfaction of the debt, the borrower is entitled to a discharge of the charge, effected by the registration on the land register of a discharge of charge in the prescribed form.

2.11 The creation, registration, enforcement and discharge of charges are governed by Part V, Division 3 of the RLL (2018 Revision). Court proceedings instituted in the enforcement process are governed by the Grand Court Rules (**GCR**)[11], Order 96, and Practice Directions[12] No. 5 of 2012, No. 4 of 2014 and No. 3 of 2015.

2.12 There is at present no distinction in the RLL between the principles applicable to charges created over bare land, as opposed to land and buildings, and neither is there a distinction between charges created over residential land, as opposed to land used for commercial or other purposes. One question to be considered during the consultation process which follows the publication of this Discussion Paper is whether different principles should apply to the enforcement of charges depending on the use to which the property over which a charge is registered is put.

(d) Creation of a Charge

2.13 A charge is created by registering with the Lands and Survey Department an instrument, known as a '*Charge*'[13], in the land register for the land which constitutes the security for the obligation secured by the charge.

2.14 Section 64 of the RLL requires that the charge instrument must contain a special acknowledgement (the **Section 64 acknowledgment**), signed by the borrower, that the borrower understands the effect of section 72, (the section which prescribes the lender's remedies).

[11] Made pursuant to s19 of the Grand Court Law.
[12] Issued by the Chief Justice, usually after consultation with the other members of the judiciary and the Grand Court Rules Committee.
[13] Form RL 9 in the Schedule to the Registered Land Rules.

2.15 The section 64 acknowledgement was clearly intended to be a safeguard for borrowers. If faithfully complied with, this requirement would ensure that the risks faced in the event of default are brought to borrowers' attention, and acknowledged by them, before they sign the charge instrument. It is not clear however as to the extent this is done in practice. For example, would the Registrar of Titles routinely refuse for registration any charge instrument presented without the section 64 acknowledgement? Further, even if the section 72 remedies are brought to borrowers' attention, to what extent are they sufficiently explained? Is it merely sufficient that the section be brought to borrowers' attention, or should borrowers also be advised on any limitations to those remedies, and as to the extent of their rights?

2.16 It would not be surprising to discover that even where the charge instrument contains the acknowledgement, there are very few cases in which there is, at the closing of a property sale, any reference whatsoever to section 72, or any of its terms. The purchase of a residential property very often marks a significant milestone for the purchaser, accompanied by the usual euphoria and excitement of the accomplishment. Hardly anyone would typically wish to dampen the mood by a detailed reference to the potential consequences to the purchaser in the event of a default.

2.17 If the above is true, then the section 64 acknowledgement will have failed in achieving its intended purpose, and the question arises whether there might be a more effective means by which this intended safeguard within the section 64 requirement might be achieved.

2.18 There may be many views on this. A number of questions arise for consideration when examining the nature and scope of any proposed reform. In the first place, would it even make a difference if every borrower is painstakingly taken through the provisions of section 72? Is section 72 sufficiently clear to alert borrowers of the real risks faced in the event of default, and in that regard, should there be more clarity within the language of section 72? Should there be more express obligations on the lender to ensure that the borrower is made aware of, and understands, not only the extent of the remedies available to the lender in the event of default, but also the procedures which must be followed in the event of default? Further, should there be mechanisms by which a borrower's rights may be protected or enforced without having to incur the expense of

court proceedings? Finally, should there be other remedies available to the lender which would be potentially less onerous to the borrower?

(e) The Usual Terms and Conditions of a Charge

2.19 The terms and conditions of the security comprised in the charge are usually set out in a schedule attached to and accompanying the charge when it is registered. Under section 67 of the RLL, there are a number of terms implied in every agreement between lender and borrower '*unless the contrary is expressed*' in the agreement. In practice, lenders routinely disapply most of section 67 and insert revised, expanded or additional terms in the security agreement. These terms and conditions include: keeping the property adequately insured; keeping the property in good repair; payment of the outgoings such as strata fees (where applicable) and water rates; the lender's right of inspection of the property; and the need for the lender's consent to create subsequent charges over the property.

2.20 There is nothing to suggest that these revised, expanded or added terms, usually introduced by lenders, are any more onerous than those which would be reasonably required to ensure adequate preservation of the property during the existence of the security. What is very often overlooked is that the lender's right to enforce its security will arise, not only in the case of a breach of the obligation to repay the secured loan and interest (known as payment obligations), but also in the event of a breach of any of the borrower's other obligations (known as performance obligations) under the security.

(f) The Lender's Remedies

2.21 The remedies available to a lender in the event of a breach of the borrower's obligations are those set out under section 72 of the RLL. There are only two such remedies:

(a) the appointment of a receiver of the income of the property; and

(b) the sale of the property.

2.22 The appointment of a receiver is uncommon in the case of residential property and will not be the focus of this Discussion Paper. The usual remedy pursued by secured lenders in the case of residential property is the sale of the property.

2.23 Upon the sale of the property, the lender is required to apply the sale proceeds in the following order of priority:

(a) towards payment of any charges which rank higher in priority;

(b) towards the costs incurred in relation to the sale;

(c) towards payment of the amount due to the lender selling the property;

(d) towards satisfaction of any subsequent charges; and

(e) the balance, if any to be paid to the borrower.[14]

2.24 If the proceeds of sale, after meeting all the priority payments, are insufficient to discharge the amount due to the secured lender in full, the lender is entitled to recover from the borrower the balance due under the terms of the existing credit agreement between the lender and the borrower.[15]

2.25 Importantly, the secured lender has no right to take possession of the property before the property is sold in exercise of the power of sale. Neither does the lender have a right of foreclosure - used in its correct sense, meaning taking over the title to the property and thereby becoming the registered owner.[16]

2.26 The public commentary on the enforced sale of properties by lenders suggests that among the most common complaints by borrowers is the amount of costs deducted from the proceeds of the sale of the property, thereby reducing the amount applied towards the outstanding principal and interest. The thrust of this complaint is that the borrower has very little, if any, control over these costs and very limited means by which to limit them. The knock on effect is that even after the property is sold there may still remain a

[14] RLL, section 76.
[15] RLL, section 72(3).
[16] This is expressly provided in section 78 of the RLL which provides, '*For the avoidance of doubt, it is hereby declared that the chargee shall not be entitled to foreclose, nor to enter into possession of the charged land or the land comprised in the charged lease or to receive the rents or profits thereof by reason only that default has been made in the payment of the principal sum or of any interest or other periodical payment or of any part thereof or in the performance or observance of any agreement expressed or implied in the charge.*' By section 75(2) of the RLL the chargee shall become entitled to recover possession of the property '*upon a bid being accepted*' on the sale of the property.

significant outstanding liability to the lender, which the lender may then pursue by further legal action.

2.27 No doubt this is one area in which the advocates for borrowers in these situations may wish to see some intervention by the law. Lenders will quite likely point to all the valid reasons why the lenders should not be made to bear the costs of a borrower's default.

2.28 Any legal interventions deemed necessary in this area will have to balance carefully the rights and interests of both parties. Consideration could well be given to alternative remedies or approaches which might incentivise a lender to limit the costs of a forced sale. One possible solution might be to reintroduce the right of foreclosure as a remedy available to lenders as a means of the lender having the ability to take title to the property, but with the consequence that upon foreclosure, all outstanding liabilities due to the lender under the secured facility are eliminated. Whether such an approach is taken will depend, at least in part, on the likelihood that lenders will opt to exercise this remedy, especially if there is no amendment to the provisions of the existing law which place no limits to the costs associated with a forced sale which may be deducted from the sale proceeds before satisfying the borrowers obligations to the lender.

(g) The Power of Sale

2.29 It is the exercise of a lender's power of sale that gives rise to most disputes between the lenders and borrowers, and this is the area where any reform of the law will likely have the greatest impact. It will therefore be the main focus of this Discussion Paper.

The Section 72 Notice

2.30 The statutory source of the lender's power of sale is section 72 of the RLL. Section 72 also prescribes the procedure to be followed by the lender before it is entitled to exercise the power.

2.31 First, the borrower must have been in default '*in payment of the principal sum or of any interest or any periodical payment or any part thereof*' (a payment obligation) or '*in the performance of any agreement*' (a performance obligation), under the charge. If the default has continued for a period of at least one month, the lender may serve a notice (referred

to as a '**section 72 notice**') on the borrower, requiring the borrower to make the outstanding payment or payments or perform the outstanding obligation.[17]

2.32 If the borrower fails to comply with the section 72 notice within three months of service, the lender's statutory power to sell the property is triggered.[18]

2.33 There are a few observations regarding the section 72 notice:

(1) The section 72 notice may be served not only in respect of a payment breach, but also in respect of a performance breach, such as, for example, the failure to keep the property insured.

(2) The RLL does not specify precisely what information should be contained in the notice. Neither is there any guidance to be found in the Banking Code as to the practice to be adopted by bankers. The result is that section 72 notices vary significantly in form and content. Some notices specify the total amount due in outstanding instalments of principal and interest. Some do not. Not all notices clearly specify the steps the borrower should take in order to remedy the default.

(3) It is not difficult to defeat the apparent intended purpose of the section 72 notice, which is, to allow the borrower an opportunity to remedy an outstanding breach. Usually this is a failure to pay outstanding monthly instalments of principal and interest. Some banks, especially in the case of a lengthy period of default, before sending the section 72 notice, serve a notice demanding repayment of the entire debt.[19] If the entire debt is not repaid within one month of the date set for repayment, this may legally constitute a default in respect of which the lender may serve a section 72 notice. The only means by which the borrower may remedy such a default would be to repay the entire debt, failing which the bank would be entitled to exercise its power of sale.

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[17] RLL, section 72(1).
[18] RLL, section 72(2).
[19] This is legally permissible where, as is almost invariably the case, the loan agreement and the schedule to the charge specify that the debt is repayable on demand. Section 64 of the RLL provides that where the loan agreement fails to specify the date for repayment of the debt, the debt is repayable three months after service of notice by the lender demanding payment (known as a '***section 64 notice')***. Most banks easily avoid the need to serve a section 64 notice by specifying that the debt is repayable '*on demand*'. Notice demanding payment and specifying the repayment date would therefore effectively avoid the need to serve a section 64 notice.

(4) The means of service of a section 72 notice are somewhat outdated. Section 72 does not specify the required mode of service. Presumably, therefore, the lender should adopt one of the methods of service of notices prescribed in section 153 of the RLL for service of notices under the RLL.[20]

(h) Exercising the Power of Sale

2.34 In the past, lenders tended to take what they considered the most careful and least risky approach to enforcement. This meant making an application to the Grand Court effectively seeking pre-approval of their enforcement process. An inordinate amount of judicial resources was being utilised on applications which, as it has turned out, were unnecessary.

2.35 The number of court applications did not abate until after the Grand Court issued a series of practice directions[21] which, not only set out the practice which lenders are required to adopt on such applications, but also the legal basis of the recommended practice. The practice directions were followed by an amendment to Order 96 of the Grand Court Rules[22] to introduce new rules specifically governing applications arising from the exercise of lenders' powers of sale.

2.36 According to the Grand Court's interpretation of how the enforcement process under the RLL is to be conducted, a lender is only required to make a court application during the enforcement process where the lender is seeking the court's approval of a variation of the terms of the RLL contained in the lender's agreement with the borrower. This arises as follows:

(1) Section 75 of the RLL sets out how a lender's statutory power of sale is to be exercised, which is by public auction, in which the lender sets the reserve price and the terms and conditions of sale.

[20] RLL, section 153, provides that notices under the RLL are deemed to have been served if: (a) served personally; (b) served on an attorney holding a power of attorney whereunder such attorney is authorised to accept service; (c) sent by registered post to the last known personal address in the Islands or elsewhere; or (d) if service cannot be effected in of the previous methods, by displaying it in a prominent place on the land affected and by publishing it in three consecutive issues of the Gazette.

[21] Practice Direction No. 5 of 2012, Practice Direction No. 4 of 2014 and Practice Direction No. 3 of 2015.

[22] This came into effect on 16 March 2015. Following this amendment the Grand Court issued Practice Direction No. 3 of 2015 which lists the real estate appraisers approved by the Grand Court for the purposes of applications relating to enforcement proceedings.

(2) Section 77 of the RLL permits a lender to vary the terms of sections 72 and 75 of the RLL in the schedule to the charge.[23] Acting pursuant to section 77, most lenders, in the standard terms of their charge schedule, routinely vary section 72 to allow the lender to enforce its security in a much shorter period following a breach than required under section 72. Similarly, the lenders' standard terms routinely vary section 75 by permitting the lender to sell, not only by public auction, but also by private agreement.

(3) There are many practical difficulties in holding a public auction in the traditional sense, whereby an auctioneer accepts the highest of progressively increasing bids. For various reasons, such auctions frequently do not result in the sale of the property. Very often the borrower's reserve is not met and the auction has had to be abandoned.

(4) The lenders, acting cautiously, and also mindful of their own interest in maximising the returns from the sale, did not wish to have the hammer knocked down on an offer which appears to be a gross undervalue. Also, a traditional public auction is somewhat out of sync with how the market for the sale of real estate tends to work in the Cayman Islands.

(5) As such, the lenders would make an application to the Grand Court for approval of the provision to sell by private contract which, pursuant to section 77, is a variation of section 75 of the RLL, which only permits a sale by public auction. In the same application, the lender would also seek approval of other variations, such as the reduction of the section 72 notice periods, both with respect to the required period of default, and the period within which the borrower is required to remedy the default.

(6) In the application, the lender would seek the court's approval for its reserve price and its proposed sale process. The court would then carefully consider and fix the terms on which the sale is to be conducted.

[23] Section 77 also permits variations of sections 70(20 and (3), 73 and 74.

(7) If the lender fails to sell the property at the reserve approved by the court, it would return to court, usually after obtaining a conditional offer for a lower price, and seek approval of the sale at the lower price. On this second or subsequent application, the lender would outline the steps it had taken to sell the property at the approved reserve price, and seek to satisfy the court that it had taken all reasonable steps to sell the property at market value.

2.37 The process was however slow and costly. It could take several months, sometimes years from the service of the section 72 notice to a court-approved sale. The burden on the court's resources was inordinate. The Grand Court therefore took the steps outlined above so that the parties would enforce their rights as was intended under the RLL, namely that the lender would exercise its power of sale without the intervention of the court, and the borrower may seek a remedy in damages if the borrower believes that the bank acted improperly in exercising its power. As a consequence, the Grand Court list now shows a significant reduction in the number of these pre-approval applications.

Redefining a Public Auction

2.38 One reason the steps taken to reduce the number of court applications proved so effective was the decision in *Scotiabank & Trust (Cayman) Ltd v Cecilia Ebanks*[24]. In that case the Grand Court determined that a sale following the marketing of the property on a multiple listing system[25] (or MLS) constitutes a public auction within the meaning of section 75 of the RLL.

2.39 The RLL does not define what constitutes a public auction for the purposes of section 75. Henderson J, in *Scotiabank v Ebanks,* adopted the definitions of an auction provided by *Oxford Dictionaries Online* and *Merriam-Webster Dictionary* respectively, to the effect that an auction is nothing more than, '*a public sale in which the goods or property are sold to the highest bidder,* and '*a sale of property to the highest bidder.*' The court found that '*the listing of real estate on the Multiple Listing Service has all the essential attributes of a reverse auction,*'

[24] Unreported, 12 January 2012.
[25] Such as the multiple listing system operated by the Cayman Islands Real Estate Brokers Association (CIREBA).

also referred to as a '*Dutch auction*', in which property is listed for sale initially at a high price, which is lowered progressively until a sale is effected.[26]

2.40 *Scotiabank v Ebanks* was applied to great effect by Practice Direction No. 4 of 2014, which states that an application by a lender for permission to sell a property by private contract '*will not be entertained unless there has been a fair attempt to market the property for sale on the open market, including by way of* [a sale on the Multiple Listing System].' The practice direction went further and intimated that a lender which felt the need to seek the court's approval of its acceptance of an offer obtained following a public auction process, as so defined, may be penalised in costs since the court '*will always be mindful of the fact that a chargee is not obliged to seek sanction of the court in the exercise of its power of sale …*'

2.41 There has already been a suggestion that the decision in *Scotiabank v Ebanks* may be inconsistent with the definition of an auction adopted by English courts in certain decisions, namely, *Harvela v Royal Trust Co of Canada (CI) Ltd*[27]and *R v Taylor*[28], which were not brought to the attention of Henderson J in *Scotiabank v Ebanks*: See, Memo to the Hon. Wayne Panton, dated 1 March 2016, from the Caymanian Bar Association Student Chapter, Mortgage Law Review Committee (the **Memo**).

2.42 The thrust of the argument is that a series of increasing bids is an essential feature of an auction. On close review of the judgments in *Harvela v Royal Trust Co* and *R v Taylor*, neither case supports the argument in the Memo.

2.43 In *Harvela v Royal Trust Co,* the main issue was whether the sale in question was a sale by '*referential* bids' (where bidder may submit a bid by reference to another bid), or a fixed bid (where the price stated in the bid would be binding on the bidder), if accepted by the vendor. The House of Lords accepted that either form of bidding would constitute a sale by auction.

2.44 In *R v Taylor,* the issue was whether the defendant had committed an offence under a statute which imposes a penalty for acting as an auctioneer without a licence. The decision turned entirely on an interpretation of the statute which, in particular, provided

[26] See para 5 of the judgment.
[27] [1985] AC 2017 (House of Lords).
[28] [1824] M'cle [362]; 148 ER 151 (Court of Exchequer of Pleas).

that the offence would be committed if a sale was conducted by certain methods specified in the statute, or '*any other mode of sale at auction or whereby the highest bidder is deemed to be the purchaser.*'

2.45 Garrow B., with whom the other two judges agreed, in distinguishing the sale in question from a sale by private contract, said, '*The main distinction between a sale by private contract, and a sale by public auction is, that the latter is a sale by increased biddings, which was the case in this instance…*'[29] The argument in the Memo, relies in part on this statement.

2.46 This statement however, does not in any way support an argument that an auction could only be conducted by way of a series of increasing bids. The closest one can get to a definition of an auction in *R v Taylor* is the statement by Garrow, B. that, in effect, a person acts as an auctioneer under the statute in every case where the person conducts a sale '*where there is open competition among persons wishing to become purchasers.*'[30]

2.47 The dictionary definition of an auction adopted by Henderson J in *Scotiabank v Ebanks* finds support from Halsbury's Laws of England/Auction (Volume 4 (2011)/1, which defines an auction as, '*a manner of selling or letting property by bids, usually to the highest bidder by public competition.*' There is also judicial endorsement of a *Dutch auction* process as being a valid auction in British Guiana (as it then was), at common law, by the Privy Council in *Demerara Turf Club, Limited (in liquidation) v Wight*[31].

2.48 If any support is to be gained from the authorities, it is to the effect that the nature and form of an auction is largely dependent on the conditions of sale prescribed by the vendor for the conduct of the auction. See, e.g., *Harvela Investments Ltd v Royal Trust Company of Canada Ltd*[32]*; South Hetton Coal Company v Haswell, Shatton, and Easington Coal and Coke Company*[33]; and *R v Taylor*[34]. That is clearly the principle underlying section 75 of the RLL, which provides that a public auction undertaken in the exercise of a lender's

[29] At p. 365.
[30] At p. 365.
[31] [1918] AC 605.
[32] *Supra*.
[33] [1898] 1 Ch. 465.
[34] *Supra*.

power of sale shall be '*subject to such reserve price and conditions of sale as the* [lender] *thinks fit …*'

2.49 Where there may exist a problem in relation to the proper application of *Scotiabank v Ebanks* is that, apart from the fact that the property is listed on the public Multiple Listing System, there are many aspects of the sale process which are, in effect, not public, so it may not be correct in such circumstances, to say that, the sale is really public.

2.50 A possible question for consideration during the reform process is whether the RLL should specify certain mandatory requirements of the public auction process. An example of this is section 5 of the *Sale of Land by Auction Act, 1867* (UK)[35], which provides that the particulars or conditions of sale by auction must specify matters such as whether the land will be sold with or without a reserve, or whether the right of the vendor to bid is reserved.

2.51 In prescribing matters to be specified, there is no reason why the statute could not be relatively expansive, permitting various forms of auctions, including *Dutch auctions* by listing on the MLS, or even Internet auctions[36].

The Sale Process

2.52 Pursuant to section 75, a lender, in exercising its power of sale, '*shall act in good faith and have regard to the interests of the chargor…*' and in the conduct of such a sale may –

(a) set the reserve price;

(b) sell the property to any person, including itself or a related party[37].

The lender is entitled to recover possession of the property once a bid has been accepted.[38]

[35] Applicable in England, W ales and Northern Ireland.
[36] In *Peter Smythe v Vincent Thomas* [2007] NSWSC 844, the New South Wales Supreme Court decided that an online auction on eBay was an auction within the meaning of the Sale of Goods Act (NSW).
[37] This is a departure from the common law under which a sale, of necessity means that the seller and the buyer must be different persons. However that difficulty, even at common law, may easily be overcome by selling to a related party.
[38] Given that most sales are carried out through the MLS this effectively means that the charge is entitled to possession once it accepts a written offer to purchase from a prospective purchaser.

2.53 The RLL does not define what constitutes acting in good faith for the purposes of section 75. There is a body of case law governing the exercise of a mortgagee's power of sale at common law which has been applied by the courts in defining the meaning of this concept.

2.54 In *Paradise Manor Ltd v Bank of Nova Scotia*[39], the leading Cayman Islands authority on the issue, the Cayman Islands Court of Appeal accepted statements defining the nature and scope of a mortgagee's duty at common law by the Privy Council in *McHugh v Union Bank of Canada*[40], and in *Tse Kwong Lam v Wong Chit Sen*[41], and by the English Court of Appeal in *Cuckmere Brick Co. Ltd v Mutual Finance Ltd.*[42], as appropriately defining the duty owed by a lender in exercising its power of sale under section 75 of the RLL.

2.55 In accordance with these principles, a lender has a duty to behave as a reasonable man would behave in selling his own property, and as such, is obliged to take all reasonable precautions to obtain the best price at the time of sale. In discharging this duty, the lender does not act as trustee for the borrower and, for example, need not wait on the recovery of a bad market before it sells.

2.56 This is one of the most common areas of conflict between lenders and borrowers. The sale price is the greatest determining factor to the amount which will be applied towards the secured debt and, ultimately, the amount, if any, which will be paid to the borrower after the sale. The dispute is very often triggered by a difference between the ultimate sale price and the market value assigned to the property prior to the sale process by a professional chartered surveyor.

2.57 The Cayman Islands courts have given the clearest indication as to how they will approach this dispute. The courts' approach focuses on the steps taken by the lender to market the property rather than on the purchase price obtained. As stated by the Grand

[39] 1895 CILR 437.
[40] [1913] A.C. 299.
[41] [1983] 1 W.L.R. 1349.
[42] [1971] 2 All E.R. 633.

Court in *Scotiabank (Cayman Islands) Ltd v Rankine*[43], the best evidence of the market value of a property is the market reaction to the property on sale, rather than the value assigned by a professional appraiser.

2.58 There can be significant variation in the marketing processes adopted by different lenders. There is no clear guidance from the above principles as to whether any particular set of steps taken by a lender will satisfy the '*acting in good faith*' standard.

2.59 Applying the above principles, there may be some identifiable practices which would seem clearly to fall outside the standard. For example, a sale which is defined in terms such as '*Bank Sale*', or '*Foreclosure*', would seem not to be consistent with the standard that the lender must behave as a reasonable man would behave in the sale of his own property. Reasonable persons would not signal to the world that the sale of the property is taking place in distressed circumstances.

2.60 Similarly, a sale by a lender to itself or a related entity, or some connected party such as an employee, although permitted under section 75, would no doubt attract a very high degree of suspicion, and the lender in those circumstances would have a high burden in showing that this was as beneficial to the borrower as a sale to an unrelated party.

2.61 It is also relatively safe to conclude that a lender will have failed in its duty if it markets the property for sale without reference to the most obvious features likely to have an impact on the sale price. For example, in the Cayman Islands context, failure to mention that a property is '*ocean front*' or '*canal front*' is likely to be seen as an objectionable omission.[44]

2.62 There are many areas of uncertainty still left to be tested before the courts. Questions which frequently arise include: what is a sufficiently long period at which to keep the property on the market; and at what point would it be reasonable for the lender to reduce the advertised market price where it receives no offers at a given price.

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[43] 2004-05 CILR Note 26.

[44] In *Cuckmere Brick Co, Ltd v Mutual Finance Ltd* (*supra*) the mortgagee was found in breach of its duty to act in good faith because, although the property was advertised as having the benefit of planning permission for construction of 100 houses, the advertisement failed to mention the fact that the property also had the benefit of planning permission for constructing an additional 35 flats.

2.63 There is a lack of detail in The Banking Code as to what local banks consider to be best practice in this area. The only guidance as to how the banks will act when exercising their powers of sale appears at clauses 14.7 and 14.8 of the Code. [45]

2.64 There is nothing in the Code regarding how banks should advertise the property for sale, how the property ought to be described in such advertisements, the duration of the marketing process, and what steps the banks should take before accepting an offer to purchase.

2.65 Apart from the statement that banks will not sell to employees or close associates, there is no other indication of the banks' practice in deciding whether any particular offer will be accepted or refused.

Remedies Available to a Borrower

(a) The Right to Redeem the Property

2.66 Consistent with a common law mortgagor's equity of redemption, a borrower under the RLL may have the charge discharged by paying the outstanding debt due to the lender, plus all of the lender's costs incurred in exercising its power of sale.[46] If the borrower chooses to redeem the property before the due date for repayment, the RLL requires that the borrower may do so (subject to any contrary terms agreed between the parties) by paying, in addition to the balance of principal and any interest past due, the interest which would have been payable up to the end of the term of the secured loan.[47]

2.67 The standard terms adopted by local banks usually do not contain the latter requirement. Many, as a marketing inducement, offer loans with no prepayment penalty, or, if there is to be a penalty for early repayment, such a penalty would be limited to no more than three months interest, which is also often limited to repayment within a certain time after the granting of the loan, or to circumstances where the charge is being transferred to another bank.

[45] See para 1.7 above.
[46] RLL, section 70(1).
[47] RLL, section 70(2).

2.68 Had the banks insisted on a prepayment penalty equivalent to the interest on the remainder of the term of the loan, the right of early redemption would hardly be attractive, as it would only be attainable by paying a very severe penalty. This is an area in which it might be said that market forces have prevailed to the benefit of borrowers.

2.69 The borrower's right to redeem the property ends once the property has been sold after an auction (or sale through the MLS) under section 75.[48]

(b) Damages

2.70 The RLL specifies that once the power of sale has been exercised and the property has been transferred by the lender to a purchaser, the borrower's only remedy is a claim for damages against the lender.[49] This is consistent with the principle of indefeasibility of title which underlies the Torrens system of registration of titles, which is incorporated by the RLL at section 38.

2.71 This suggests that any action to prevent a lender exercising its power of sale would have to be taken before a sale is concluded. Although it appears that the matter has not been expressly addressed in a reported Cayman Islands case, applying general principles, it appears unlikely that a court would grant an injunction to prevent a sale only on the grounds that the proposed sale is at an undervalue. That arises from the fact that the RLL already prescribes a remedy in damages.[50]

2.72 That is not to say that the court would never grant an injunction to prevent a sale. It is inconceivable that the court would allow a lender to perpetrate a fraud against a borrower. There may also be circumstances where damages may well be shown not to be an adequate remedy. Absent fraud, the right to an injunction ceases upon a sale of the property and as such any action for an injunction would have to be taken before an offer to purchase is accepted by the lender.

[48] RLL, section 70(1).
[49] RLL, section 70(3).
[50] See *Scotiabank & Trust (Cayman) Ltd v Barnes* [2016 (2) CILR Note 7].

3. OPTIONS FOR REFORM

3.1 The initiatives taken by the Grand Court, applying the developing case law, only became necessary because the provisions of the RLL which prescribe a lender's power of sale are insufficiently clear and in need of reform. After all, the RLL was intended to be a comprehensive legal code and where such a code is deficient it is for the legislature and not the courts to remedy the deficiencies.

3.2 The nature and scope of reform ultimately adopted will no doubt mainly reflect the policy of the government of the day. The purpose of this Discussion Paper is to identify some possible options for reform which might be adopted.

3.3 The structure of the reform could vary from:

(a) introducing new legislation governing the exercise of the power of sale over residential property; or

(b) amending the relevant provisions of the RLL, or introduce subsidiary legislation aimed at remedying some of the deficiencies identified by the courts and in this paper.

(a) Enacting new provisions through new legislation or amendments to the Registered Land Law

3.4 The RLL makes no distinction between charges created over residential property and those created over others, such as industrial or commercial property. The Commission is in the process of considering proposals for the introduction of consumer protection legislation, but as matters stand, there is no legislation outside the RLL which is capable of affording protection to the owners or occupiers of residential property when faced with enforcement proceedings undertaken by secured lenders.

3.5 In the view of the Commission, the review of the law relating to enforcement of security over land, as set out above in this paper, supports the need for reform of the applicable law. The Commission believes that this may be best achieved by the introduction of new legislative provisions aimed at: remedying some of the clear deficiencies in the existing legislation; clarifying some of the existing provisions under the RLL; and creating enhanced protections for borrowers in certain areas. Although it may be necessary to introduce measures which will apply to all types of real property, it is clear

that the greatest concerns relate to the impact of the existing legislation on residential property owners.

(b) Adopting the EU Directives

3.6 If new legislation is to be introduced it would probably produce the most immediate impact if it takes the form of consumer protection legislation specifically applying to the enforcement of security over residential property. In this regard, consideration may be given to the recommended governing principles of such legislation set out in the Directives of the European Parliament and of the Council, dated February 2014, on credit agreements relating to residential immovable property (the **EU Directives**)[51].

3.7 Some of the legislative principles set out in the EU Directives which could be of relevance to new legislation considered for introduction in the Cayman Islands are:

(1) The promotion of measures that support the education of consumers in relation to responsible borrowing and debt management;

(2) The introduction of measures which will require that the providers of secured credit, when creating the agreements which will lead to the secured loan shall act in a manner which is honest, fair, transparent and professional, taking account of the rights and interest of consumers;

(3) A requirement that any advertising concerning such agreements must specify certain information such as: the borrowing rate and whether such rate will be fixed or variable; the duration of the term of the loan; the amount of the instalments; the number of instalments; and a warning of any factors which may result in an increase in the amount payable by the borrower;

(4) Requiring that lenders provide a customer seeking credit with personalised information enabling the customer to compare the options for credit available in the market, to assess their implications and to make an informed decision as to whether to enter into the agreement;

[51] https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex:52011PC0142.

(5) The creation of and ensuring access to a database for all lenders containing information which would allow existing and prospective lenders to assess and monitor the creditworthiness of their borrowers;

(6) A requirement that borrowers be allowed to repay their indebtedness in full or in part prior to the expiry date without penalty for so doing;

(7) The introduction of measures to encourage lenders to exercise forbearance before enforcing their powers of sale – for example:

(a) allowing the lender to impose reasonable additional charges on the borrower in the event of a default; and

(b) allowing the lender and borrower to agree in their credit agreement that the borrower may transfer the property to the lender in total satisfaction of the outstanding debt;

(8) Ensuring that appropriate and effective complaints and redress procedures exist for the out-of-court resolution of disputes between borrowers and lenders, using existing bodies where possible.

(c) Adopting Specific Legislative Measures in Other Jurisdictions

3.8 There are other jurisdictions which have enacted legislation which may also serve as useful guides for any new or amended legislation to be adopted in the Cayman Islands. The Commission considers it worthwhile to consider the following provisions from the following jurisdictions which may be of relevance to the identified deficiencies of the Cayman Islands legislation.

United Kingdom

(i) The Law of Property Act, 1925

3.9 Section 103 of the Law of Property Act, 1925 (applying to England and Wales) provides that a mortgagee shall not exercise the power of sale unless and until—

(a) Notice requiring payment of the mortgage money has been served on the mortgagor or one of two or more mortgagors, and default has been made in payment of the mortgage money, or of part thereof, for **three months after such service**; or

(b) Some interest under the mortgage is in arrear and unpaid for **two months after becoming due**; or

(c) There has been a breach of some provision contained in the mortgage deed or under the Act, on the part of the mortgagor, other than a covenant for payment of the mortgage money or interest. (Emphasis added.)

3.10 These provisions are not dissimilar to the provisions under section 72 of the RLL. The period of the default notice (three months) is identical to the period under the section 72 notice, but the pre-existing default period is two months in England, compared to one month in the Cayman Islands.

(ii) Pre-action Protocol

3.11 There is a pre-action protocol for possession claims relating to mortgage arrears. The protocol does not change the legal rights and obligations of the mortgagor and mortgagee. It however sets out the conduct of the parties that the courts will consider before making an order for possession.

3.12 The stated aims of the protocol are to:

(a) ensure that the lender and the borrower act fairly and reasonably with each other in resolving any matter concerning mortgage arrears;

(b) encourage greater pre-action contact between the lender and the borrower in order to seek agreement between the parties, and where agreement cannot be reached, to enable efficient use of the court's time and resources; and

(c) encourage lenders to check who is in occupation of the property before issuing proceedings.

3.13 The protocol addresses, among other matters: the initial contact and provision of information by the lender to the borrower; the postponement of the start of a possession claim; and further matters to be considered before commencing a possession claim.

(iii) Initial Contact and Provision of Information

3.14 The protocol recommends that, among other things, the lender must provide the borrower with:

(a) information on the current monthly instalments and the amounts paid for the last two years; and

(b) information on the amount of the arrears, which should include –

(i) the total amount of the arrears;

(ii) the total outstanding on the mortgage; and

(iii) whether interest or charges have been or will be added, and, where appropriate, details or an estimate of the interest or charges that may be payable.

3.15 The lender must consider a reasonable request from the borrower to change the date of regular payment (within the same payment period) or the method by which payment is made.

3.16 The lender must respond promptly to any proposal for payment made by the borrower.

3.17 If the lender submits a proposal for payment, the borrower must be given a reasonable period within which to consider such proposals.

3.18 If the borrower fails to comply with an agreement, the lender should warn the borrower, by giving 15 days notice in writing of its intention to start a possession claim.

(iv) Postponing a Possession Claim

3.19 The lender should not start a possession claim for mortgage arrears where the

borrower can demonstrate that he has submitted a claim to the Department for Works and Pensions, or a local authority, for various benefits (which have no current equivalent in the Cayman Islands), or to an insurer under a mortgage payment protection policy. The protocol recommends that the lender postpone the proceedings where the borrower provides evidence of a reasonable likelihood of obtaining the benefits or recovery under the insurance policy, or provide evidence of an improvement in the borrower's financial circumstances in the foreseeable future.

3.20 Where the borrower can demonstrate that reasonable steps will be taken to market the property, at a reasonable price, with appropriate professional advice, the lender must consider postponing starting a possession claim to allow the borrower a realistic period to sell the property. Where the lender agrees to postpone starting a possession claim, the borrower must provide the lender with, among other things, the particulars of sale, and details of the estate agent instructed to deal with the sale.

3.21 Where the lender decides not to postpone the start of a possession claim, the lender must provide the borrower with the reasons for its decision at least five business days before starting proceedings.

(v) Further matters to be considered before starting a possession claim

3.22 The protocol recommends that starting a possession claim should be a last resort, and a claim must not normally be started unless all other reasonable attempts to resolve the situation have failed. The protocol recommends that before commencing a possession claim the parties should consider alternative solutions such as –

(a) extending the term of the mortgage;

(b) deferring payment of interest due under the mortgage;

(c) capitalising the arrears.

(vi) Relevant matters when considering the England Wales Pre-action Protocol

3.23 If a similar protocol were to be adopted in the Cayman Islands, to be effective, there will be a need for significant amendments to the law and procedure for the exercise of the power of sale.

3.24 At present, the lender is not entitled to possession merely by virtue of there being a default in the obligations under the charge.[52] The lender becomes entitled to possession upon the acceptance of an offer to purchase pursuant to the exercise of the power of sale.[53] Further, based on the firm statements in the Grand Court practice directions previously referred to,[54] there may be adverse costs consequences to a lender who makes a court application for directions regarding the exercise of its power of sale before taking steps to sell the property by public auction, as now defined. Under the present statutory and procedural regime there is very limited scope for a pre-action protocol to be effective.

3.25 This does not suggest that there would be no utility to the adoption in the Cayman Islands of a similar protocol relative to the exercise of a lender's power of sale. Such a protocol could, for example, prescribe matters to be taken into consideration by the Court when considering whether a lender has '*acted in good faith*' and has had due regard to the interests of the borrower, within the meaning of section 75 of the RLL. This is a relevant factor, both to an application for approval of variations of the provisions of the statute by the terms of the charge, and to proceedings brought after the sale, relating to whether the lender has acted reasonably in the exercise of the power of sale.

3.26 It would appear that if such a protocol were to be effective within the current statutory and procedural scheme it would have to be imposed as steps to be taken either prior to or after the issue of a section 72 notice, and in such a manner that failure to comply with the protocol would affect the validity of a section 72 notice.

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[52] RLL, section 78.
[53] RLL, section 75(2).
[54] Para. 2.35 and footnote 21 above.

(vii) The Consumer Credit Act, 1974

3.27 Section 88 of the Consumer Credit Act, 1974 contains a number of provisions with regard to the contents of the default notice to be served on a debtor in default which may usefully be adopted with respect to the section 72 notice of the RLL or its statutory replacement.

(1) The default notice must specify—

(a) the nature of the alleged breach;

(b) if the breach is capable of remedy, what action is required to remedy it and the date before which that action is to be taken;

(c) if the breach is not capable of remedy, the sum (if any) required to be paid as compensation for the breach, and the date before which it is to be paid.

(2) The default notice must contain information in the prescribed terms about the consequences of failure to comply with it and any other prescribed matters relating to the agreement.

(3) The default notice must also include detailed information specifying the extent of the default.

(4) A default notice may include a provision allowing the borrower to remedy the breach at any time after the expiry of the notice (but before the exercise of the power of sale), together with a statement that the provision will be ineffective if the default is duly remedied.

Ontario, Canada

3.28 The statutory position in Ontario, Canada is similar to the position in the Cayman Islands but with some important differences.

3.29 Under section 24 of the Mortgages Act, 1990, which is the equivalent of section 72 of the RLL, a mortgagee's power of sale arises **three months after default** in the payment of principal or interest, or in the payment of any **insurance premium due** on the property. This compares with the one month requirement under section 72 of the RLL. Note however that the Ontario power of sale does not arise in respect of performance default except for failure to pay the insurance premium.

3.30 The prescribed manner of sale is similar to that provided for under section 75 of the RLL. The Ontario provision expressly permits a sale by private contract in addition to a sale by public auction.

3.31 An amendment to section 75 of the RLL to permit sales by private contract is worthy of consideration. The current sale process in the Cayman Islands is in effect a private sale. Although it may be accurate that a sale on the MLS is a reverse mortgage, it is doubtful whether that was contemplated at the time section 75 of the RLL was enacted. Calling a sale on the MLS a public auction does have a ring of artificiality.

3.32 The notice of default, the equivalent of the section 72 notice in the Cayman Islands, prevents the mortgagee from exercising the power of sale until after 45 days after service of the notice. This compares with three months under the RLL. As such, the total period from the date of default to the date the power of sale arises is approximately 135 days in Ontario, and approximately 120 days in the Cayman Islands.

3.33 The Ontario statute prescribes the persons on whom the default notice must be served including all prior and subsequent mortgagees, and any other persons appearing to have a registered interest in the property.

New South Wales, Australia

3.34 The Real Property Act, 1990, the governing statute in New South Wales, Australia, also prescribes the persons on whom the equivalent of the section 72 notice must be served. These include every prior or subsequent mortgagee, and every caveator (the equivalent of a person lodging a caution under the RLL).

3.35 Importantly, the statute also prescribes the means of service and the required contents of the default notice. For example the statute prescribes that the notice specifically require the mortgagor:

(a) to observe the agreement or condition in respect of the observance of which the mortgagor is in default; or

(b) to pay the principal, interest, annuity, rent-charge or other money in respect of the payment of which the mortgagor, charger or covenant charger made default; and

(c) and to pay a reasonable amount for those costs and expenses and specifies the amount.

3.36 The notice is also required to notify the mortgagor that, unless the requirements of the notice are complied with within one month after service of the notice (or, where some other period exceeding one month is limited by the mortgage), it is proposed to exercise a power of sale in respect of the mortgaged property.

3.37 The statute further specifies that where the mortgagor satisfies the requirements of the notice to which the notice relates shall be deemed not to have occurred.

4. CONCLUSION

4.1 The review of legislation in comparable jurisdictions suggests that the law in the Cayman Islands relating to the enforcement of mortgage security is not significantly out of sync with the law in these jurisdictions. There are however provisions and practices which are well worth adopting. There are also some provisions of the RLL which could benefit from clarification.

4.2 A number of these reforms may be adopted by amendment of existing laws or by adopting rules and regulations under such laws. Given the specific concerns raised regarding the enforcement of these powers where they affect residential property, consideration should be given to whether the reforms should be introduced in separate legislation dealing only with enforcement procedures affecting residential property.

4.3 The questions which the Commission recommends should be addressed during the consultation process are set out at paragraphs 1.14 to 1.16 above. It is hoped that the consultation will stimulate sufficient discussion and participation which may guide the Commission through subsequent stages of the reform process.

Chairman
Cayman Islands Law Reform Commission
23rd November, 2018

Stakeholders and members of the general public are invited to generally comment on the issues identified in the Discussion Paper and, in particular, to submit their comments on the questions presented for discussion.

The Paper may be viewed on the following website: www.lrc.gov.ky or www.gov.ky. Unless marked to the contrary, the LRC will assume that comments received are not confidential and that respondents consent to our quoting from, or referring to, their comments and attributing their comments to them, and to the release or publication of their submissions.

Requests for confidentiality or anonymity will be respected to the extent permitted by the Freedom of Information Law (2018 Revision).

Submissions should be forwarded no later than 30th April, 2019 to the Director of the Law Reform Commission, 4th Floor Government Administration Building, Portfolio of Legal Affairs, 133 Elgin Avenue, George Town, Grand Cayman, P.O. Box 136, Grand Cayman KY1-9000 either (a) electronically to jose.griffith@gov.ky or (b) in writing, by post or hand delivered.