Statement for the Record

On Behalf of the

American Bankers Association

Before the

Subcommittee on Antitrust, Commercial, and Administrative Law

Of the

House Judiciary Committee

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Chairman Cicilline and Ranking Member Buck, thank you for the opportunity to submit this statement for the record on behalf of the members of the American Bankers Association (ABA)[1] for the hearing titled "Oversight of the Bankruptcy Code, Part 2: Ensuring a Fresh Start for Consumers." As the Subcommittee considers bankruptcy law changes, the ABA would like to provide its views on proposals to change the bankruptcy code with respect to consumer bankruptcies.

I. Current Bankruptcy Law Provides Balanced Protections for Both Debtors and Creditors.

Congress last made major changes to federal bankruptcy law in 2005 by enacting the Bankruptcy Abuse Prevention and Consumer Protection Act (Pub. L. No. 109-8) (BAPCPA). In the interim, there have been a few changes, such as an expedited procedure for small businesses,

[1] The American Bankers Association is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard nearly $19.6 trillion in deposits and extend $11.8 trillion in loans. Learn more at www.aba.com.

but overall the current bankruptcy system provides a balanced, carefully calibrated mechanism to allow borrowers a "fresh start" without unduly restricting the availability of consumer credit. Many Americans rely on credit for emergency purchases and benefit from the flexibility of repayment terms. In the nearly two decades of jurisprudence since BAPCPA was enacted an efficient bankruptcy system has been put in place that supports lower credit costs for all borrowers.

History demonstrates that liberalizing bankruptcy reform would come at the expense of higher costs and lower credit availability for consumers and small businesses. An increase in bankruptcy filings undermines loan quality for lenders and leads them to raise interest rates and fees and tighten credit standards. This burden would fall disproportionately on lower-income borrowers, who already face challenges obtaining credit.

BAPCPA Reduced Filings and Increased Credit Quality

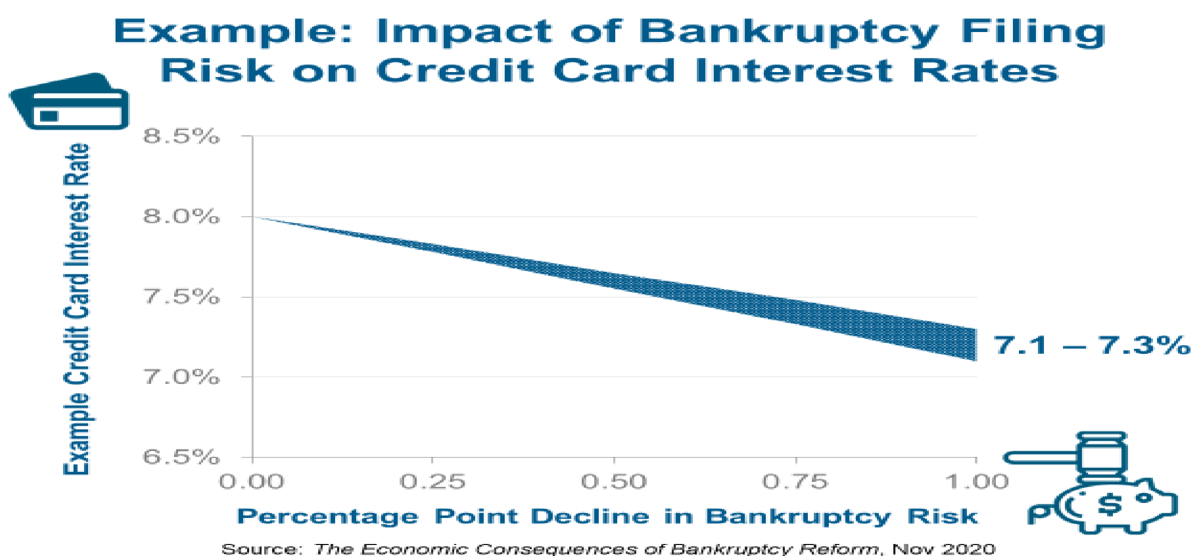
Personal bankruptcy filings peaked at 2 million in 2005 before the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). The BAPCPA led to a significant reduction in filings and, according to a CFPB report, a notable drop in defaults and delinquencies. This credit quality improvement applied to all borrowers, even prime and subprime borrowers.

Recent data indicates that bankruptcy filings are beginning to increase, although still low in comparison to pre-BAPCPA filings (See https://www.aisinfo.com/blog/2022/09/ais-insight-

blog-august-2022). This means that Congress should be even more wary of changes to the Bankruptcy Code that would accelerate this trend and create even more upward pressure on credit costs for consumers and businesses already facing increased prices due to inflation and supply chain disruptions across our economy.

Fewer Bankruptcies = More Credit Supply and Lower Costs

Improvement in loan quality allowed lenders to expand credit supply and pass savings on to consumers. Studying the impacts on consumer credit cards, the same report found that a 1-percentage point decline in bankruptcy-filing risk within a credit-score segment led to an average 70- to 90- basis point drop in interest rates.



Expanding Bankruptcy Property Exemptions Harms Small Businesses and Consumers

A separate report found that as property exemption limits increased, credit availability for small businesses fell. This led to fewer establishments and lower wages for employees, "particularly for small businesses with less than five employees." Another study also found it led to a redistribution of personal loans from mid-wealth entrepreneurs to those at higher income levels. Finally, a 2018 paper found that reducing default payment obligations leads to increased interest rates on non-housing loans, ultimately leaving borrowers in a worse position. Every dollar a borrower saved in lower default expenses cost around $5 in higher interest.

ABA believes any proposed bankruptcy law changes must not disturb the balance that presently exists. Permissive bankruptcy rules are associated with increases in the cost of credit and/or a reduction in the availability of credit. In light of the challenges from inflation that American consumers face, Congress should be wary of further burdening consumer through the unintended consequences or indirect impacts of proposed changes to the Bankruptcy Code.

II. **ABA Views on Proposed Legislation**

The ABA would also like to provide its views on The Consumer Bankruptcy Reform Act, which was introduced on September 28 by Senator Warren and Chairman Nadler ("CBRA") and similar legislation. Although intended to make it easier and less expensive for consumers to obtain meaningful bankruptcy relief, the CBRA's expansive and permissive provisions would significantly increase creditor losses, leading to the unintended consequence of increasing the cost of providing credit for consumer lenders in virtually every area of business.

The CBRA would adversely affect consumers and all types of creditors. It would abolish Chapter 7 (liquidation) and Chapter 13 (court-supervised repayment) for consumers, both of which have been prominent features of American bankruptcy practice for decades. A new Chapter 10 would replace those Chapters for consumers with less than $7.5 million in debts. Unlike current law, many debtors will receive a discharge of debt up-front, without being required to meet any financial obligations. Chapter 10 also purports to separate debtors into repayment plans based on a combination of the debtor's available assets and future income. While some debtors in Chapter 10 would have a "minimum payment obligation," consumer advocates predict that the vast majority of debtors will have no payment requirement whatsoever. This will result in losses that will be passed on to consumers already struggling from both the recent rise in inflation and the corresponding rise in interest rates meant to address inflation.

For the rare debtor who will be required to repay at least some debts, the debtor will propose a repayment plan, addressing the debtor's personal liability on unsecured and secured obligations over three years (in contrast to the five-to-seven-year period under current law).

Thus, under the CBRA, either the debtor or her creditors will unnecessarily be required to bear a far greater burden (in payment amount for the debtor, or payment reduction for the creditor) than is required under current law. Furthermore, even when a debtor is required to make payments, the debtor may be "justly excused" for "circumstances that [the] debtor cannot reasonably avoid," and creditors may seek dismissal of a case only for a "manifestly improper use of the bankruptcy system." These are both vague standards, which would be difficult to establish, and which would invariably lead to a lack of uniformity under the law. Finally, while the CBRA's purported goal is to make it easier and less expensive for consumers to obtain meaningful bankruptcy relief, it would do just the opposite because it contemplates authorizing separate repayment plans for unsecured and secured debts, thereby unnecessarily expanding and layering the process while turning the Bankruptcy Code's priority scheme on its head.

Importantly, the CBRA's enforcement mechanisms are unworkable and unfair. As an initial matter, the CBRA unreasonably places the burden of enforcing Chapter 10 repayment obligations solely on trustees, many of whom do not have the infrastructure for this expanded role. Additionally, debtors have few consequences for missing payments as there is no impact on the previously entered discharge and creditors cannot act to remedy payment defaults. Under the CBRA, there would be no meaningful consequence for failure to make payments under a Chapter 10 plan, which is manifestly unfair. The bill also removes the pre-bankruptcy credit counseling requirement, a change that likely will increase bankruptcy filings as consumers in financial distress are less likely to be aware of other options to bankruptcy.

While CBRA would discourage debtors from completing plan payments, by granting discharge upfront and providing creditors with no plan default remedies, it would significantly expand a borrower's ability to reduce the amount of debt secured by a mortgage or vehicle security interest to the value of a home or car at the time a bankruptcy is filed. This will override the terms of mortgage and vehicle financing arrangements, significantly increasing the risk for lenders and investors who hold portfolio loans when property values decrease.

Because consumers are allowed broad home loan exemptions, BACPBA rightly limited cramdown of those loans. Individual debtors can choose to keep their homes and force creditors to honor a bankruptcy plan and the mortgage agreement despite defaults. However, if the creditor must continue with the risk of honoring the agreement, the borrower did not get the

benefit of reducing the liability to liquidation value as of the petition date. BAPCPA created a balance and because of the borrower's broad rights to retain the property, it only allows cramdown of home loans in cases where the debt can be paid off during the term of the bankruptcy plan.

The CBRA distorts the balance achieved since 2005, by expanding cramdown rights and allowing mortgage cramdowns without the goal of discharge. The CBRA would allow up front discharge of debt without any requirement to meet existing financial obligations, such as the obligations associated with a crammed down loan, and repayment plans for secured debts would be based on a combination of available assets and future income regardless of whether it is a long-term debt. In addition, expansive cram downs return auto lenders to their pre-2005 position, which substantially limited credit availability. Further residence and property repayment plans can adjust interest rates and maturity dates – potentially affecting the value of underlying mortgage loans creditors, and unnecessarily burdening consumer borrowers with lengthier loan terms whose consequences they cannot presently foresee. Therefore, we are concerned that the expanded mortgage and vehicle security interest cramdown that the CBRA provides, will result in losses that will be passed to consumers already struggling with inflated prices and higher interest rates, and will place some reorganized debtors in difficult positions later in life that they cannot presently foresee.

Moreover, the CBRA's expansion of exemptions will disproportionately benefit wealthier consumers, while increasing the cost of borrowing and decreasing access to credit for others. The CBRA would expand the current law's authorization for debtors to exempt certain property from creditors' claims. Under the CBRA, a debtor would be allowed to choose between a set of federal exemptions and the debtor's state law exemptions. States cannot opt out of the federal exemptions, however. The CBRA's expanded exemptions, including the wildcard exemption, make bankruptcy more attractive to wealthier consumers with significant resources, who would be able to shield substantial assets while shedding debts under less than equitable terms.
This expansion disproportionately benefits wealthier consumers who are more likely to own multiple properties, have home equity and be better off than renters. At the same time, this change will likely chill credit markets, increase the cost of mortgages, harm first-time homebuyers who already face higher mortgage rates today.

The CBRA also gives the CFPB the statutory right to be heard in any bankruptcy case similar to the statutory right already provided to United States Trustees. Among other things, the CFPB will have the authority to enforce its prohibition on unfair, deceptive, and abusive acts in bankruptcy courts. It will also be tasked with creating a "Consumer Bankruptcy Ombudsman". Banks who are alleged to have violated consumer protection laws can be barred from collecting in bankruptcy cases, through the court approved bankruptcy process. Finally, the CBRA directs courts to interpret its provisions “liberally in favor of relief for consumer debtors.” In other words, the new bankruptcy system established under the CBRA would not consider the settled expectations of creditors, would result in reduced collections and increased losses to banks, and would affect multiple bank lines of business – home mortgages, auto lending, credit cards and student loans.

The CBRA – and proposals like the CBRA – will fuel increased borrowing costs for already stressed American consumers. Congress should not add to the current inflationary and rising rate environment by enacting legislation that would, in all likelihood, reinforce rising costs for food, fuel, and shelter, and make it more difficult, rather than less difficult, for consumers to access credit under the most favorable terms.

Conclusion

The current bankruptcy system provides a balanced, carefully calibrated mechanism to allow borrowers a “fresh start” without unduly restricting the availability of consumer credit. Many Americans rely on credit for emergency purchases and benefit from the flexibility of repayment terms. Since BAPCPA was enacted, an efficient bankruptcy system has been put in place that supports lower credit costs for all borrowers. Any proposed bankruptcy law changes must not disturb the balance that presently exists. Permissive bankruptcy rules would result in increased credit costs and a reduction in the availability of credit. In light of the challenges from inflation that American consumers face, Congress should be wary of further burdening consumers through the unintended consequences or indirect impacts of proposals to change the Bankruptcy Code.