Statement for the Record

On Behalf of the

American Bankers Association

before the

Subcommittee on Antitrust, Commercial and Administrative Law

of the

Judiciary Committee

of the

United States House of Representatives

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June 25, 2019

Chairman Cicilline, Ranking Member Sensenbrenner, and members of the Committee, the American Bankers Association (ABA) respectfully requests that this statement be made part of the record for your June 25, 2019 hearing: “Oversight of Bankruptcy Law and Legislative Proposals.”

ABA is the voice of the nation’s $18 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $14 trillion in deposits and extend over $10 trillion in loans. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to the agriculture industry since the founding of our country. Nearly 5,000 banks — 83 percent of all banks nationwide — reported agricultural loans on their books at year-end 2018 with a total outstanding portfolio of more than $186 billion.

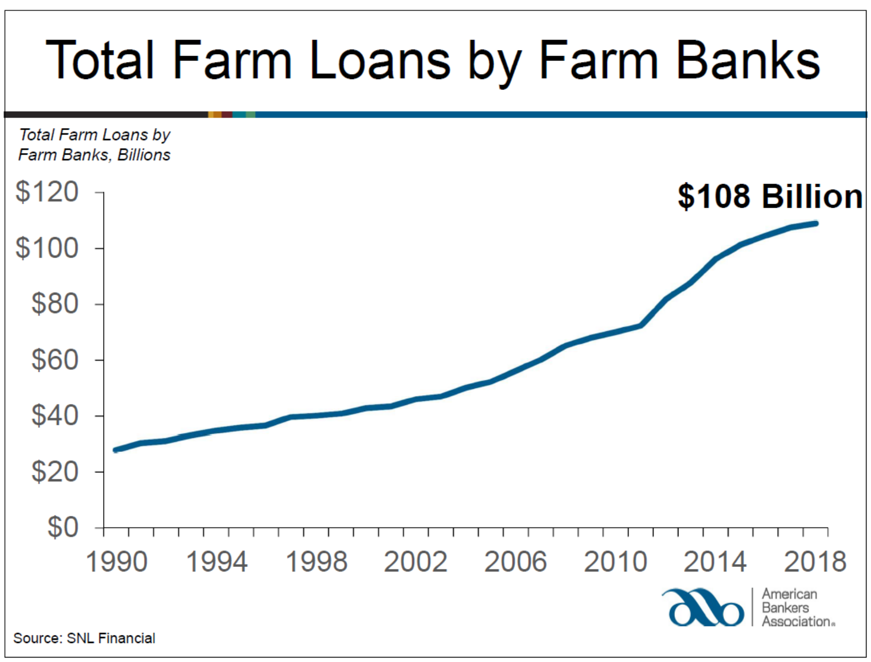
While this hearing will cover several aspects of bankruptcy law, ABA and our members are particularly concerned about H.R. 2336, the Family Farmer Relief Act, which amends Chapter 12 of the Bankruptcy Code by raising the current debt limit for Chapter 12 filings from approximately $4.3 million to $10 million.

Chapter 12 bankruptcy is a very complex issue that requires many different parties to work together. Bankers are very supportive of our farm and ranch customers and as their partners we want them to be as successful as possible. When it comes to increasing the debt limit on Chapter 12 bankruptcy by more than double – from approximately $4.3 million to $10 million – bankers are concerned that such a large increase will be detrimental to the costs of credit for farmers in the long run.

I. Banks Are a Primary Source of Credit to U.S. Farmers and Ranchers

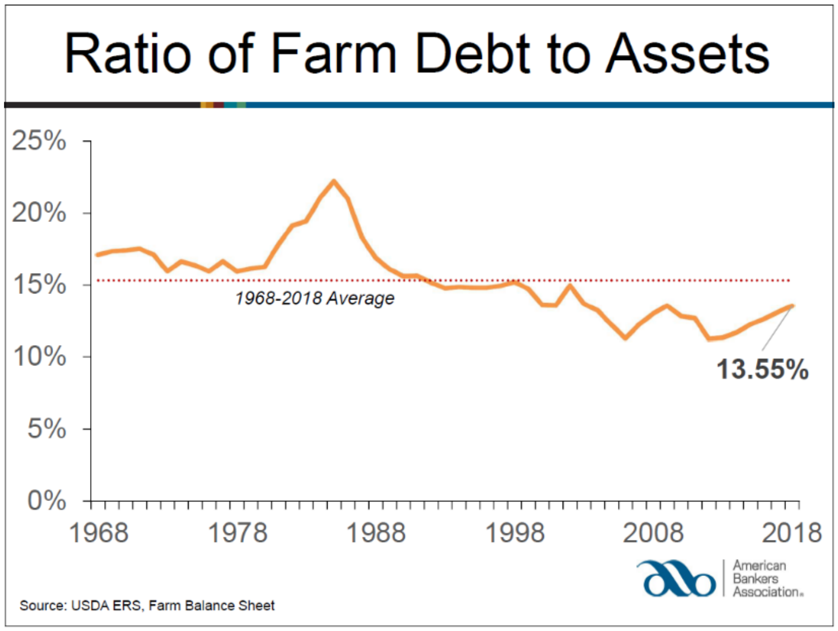
Banks continue to be one of the first places that farmers and ranchers turn to when looking for agricultural loans. Agricultural credit portfolios typically finance a wide array of customers, including large and small farms, urban farmers, beginning farmers, women farmers and minority farmers. To bankers, agricultural lending is good business.

In 2018, farm banks — banks with more than 16.05 percent of their loans made to farmers or ranchers — increased lending by 5.3 percent to meet the rising needs of farmers and ranchers, and now provide over $108 billion in total farm loans. Farm banks are an essential resource for small farmers, holding more than $49 billion in small farm loans, with $12.3 billion in micro-small farm loans (loans with origination values less than $100,000). Farm banks are healthy, well-capitalized, and stand ready to meet the credit demands of our nation's farmers large and small.



In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses such as food processors, retailers, transportation companies, storage facilities, and manufacturers, receive financing from the banking industry as well. Agriculture is a vital industry to our country, and financing it is an essential business for many banks.

The agricultural economy has been slowing, with farm sector profitability expected to decline further in 2019. The ratio of debt to assets for the farm sector has risen the past five years and is projected to increase to 13.55 percent for 2018. However, this is still below the 50-year average of 15.32 percent and far below the peak ratio reached during the farm crisis. Moreover, farm and ranch incomes have been some of the best in history.



In addition, Congress helped to greatly strengthen the farm economy with passage and enactment of the 2018 Farm Bill. With the 2018 Farm Bill in place, farmers, ranchers, and their bankers achieved a level of certainty from Washington about future agricultural policy. Interest rates continue to be at or near record lows, and the banking industry has the people, capital and liquidity to help American farmers and ranchers withstand the turbulence in the agricultural economy.

Our nation's farmers and ranchers are critical resources to our economy. Ensuring that they continue to have access to adequate credit to thrive is essential for the well-being of our whole nation. America's banks remain well equipped to serve the borrowing needs of farmers of all sizes. An important step in ensuring continued credit availability for farmers is to proceed with great caution before moving forward with the changes to Chapter 12 farm bankruptcies proposed in H.R. 2336.

II. Raising the Debt Limit on Chapter 12 Bankruptcies to $10 Million is Unjustified and Will Raise Borrowing Costs for all Farmers

If this proposal were to become law, credit terms would tighten considerably for many family farms, with a disproportionate impact on the most distressed farms most in need of credit. Chapter 12 of the Bankruptcy Code was enacted in the 1980s in response to financial problems affecting family-owned farming operations. Chapter 12 was designed to allow farmers to keep their farms but reorganize their debts and avoid foreclosure or liquidation. However, the Chapter 12 law includes unique and expansive rights for debtors that do not exist in other Chapters of the Bankruptcy Code.

For example, unlike Chapter 11, which covers typical business reorganizations, Chapter 12:

- Allows debtors to significantly reduce the amount they owe - a "mortgage cramdown" on a principal residence (often the farm) - resulting in increased losses for secured lenders.

- Prevents creditors from voting on a reorganization, which makes them unable to adequately protect their interests.

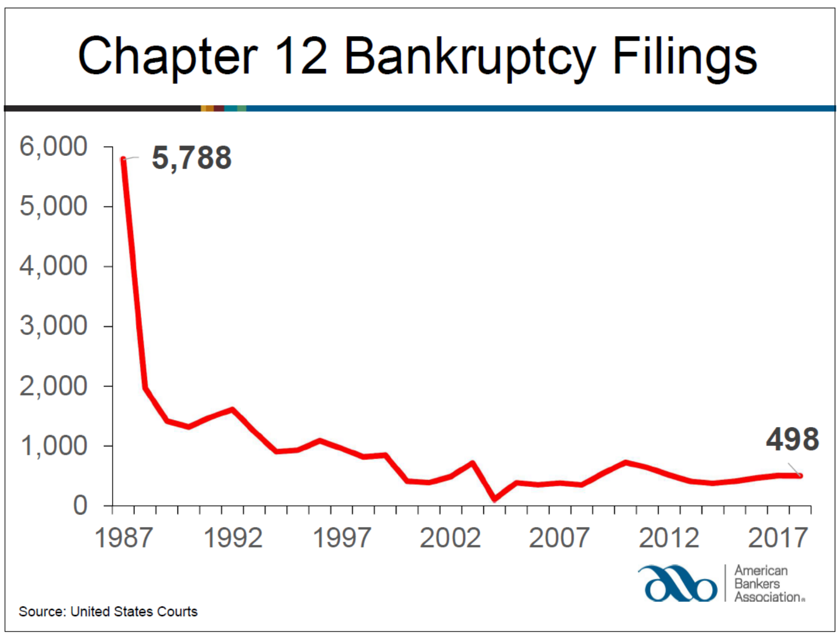
- Permits debtors to own the farming business without creditor consent or full payment of debts, which again, severely limits the ability of creditors to protect their interests.

Raising the debt limit on Chapter 12 bankruptcies from $4.3 to $10 million in one fell swoop will make the cost of borrowing higher for farmers and reduce the availability of credit. In particular, to offset the additional risk imposed on creditors, interest rates for farm borrowers are likely to rise and much higher costs will be borne by financially weaker farm borrowers, either in the form of increased interest or in their inability to obtain loans at any price.

In the past, this increase in the cost of credit attributable to Chapter 12 has been documented by the U.S. Department of Agriculture (USDA). In particular, in 1997 USDA studied the impact of Chapter 12 on farm lending and found that not only did it result in higher interest rates for farm loans to cover the additional risk, but that it also increased "direct bankruptcy costs by encouraging bankruptcy filings by some farmers who would not otherwise have done so." USDA also noted that "this impact could be mitigated by allowing lenders the option of recapturing write downs in secured debt if asset values recover. Such an option exists under Chapter 11.[1]

Importantly, the debt limit to qualify for Chapter 12 is indexed to inflation and since 2005 increases every 3 years. Despite this automatic increase, H.R. 2336 would dramatically increase the limit to $10 million. Given that the debt limit is already adjusted for inflation, there is little survey or statistical evidence that would justify an arbitrary increase of nearly $6 million in the current limit.

For instance, there are over two million farms in the United States, according to the U.S. Department of Agriculture, with an average debt of just over $202,000. However, according to statistics compiled by the United States Courts on bankruptcy filings there were only 498 Chapter 12 bankruptcies in 2018 – and this was down from 501 bankruptcies in 2017.[1]



[1] https://www.uscourts.gov/statistics-reports/caseload-statistics-data-tables

Looking at some individual states, according to a 2017 report from Iowa State University, average total liabilities for large farms in Iowa averaged $1.6 million.[2] In another example, according to one recent report, in Nebraska, average farm debt is only $1.3 million.[3]

Therefore, while we do not believe that an increase in the debt limit to $10 million is justified, there are adjustments that could be made to make Chapter 12 more balanced with respect to the interests of both creditors and debtors. For instance, the three-year inflation adjustment could be changed to an annual adjustment. In addition, there should be greater procedural fairness for creditors. USDA's recommendation for allowing the recapture of write-downs if asset values recover would be a good start from our perspective.

Conclusion

The current $4.3 million debt limit (indexed for inflation) already covers most farmers and there is no need for a dramatic increase to $10 million. If H.R. 2336 were to become law, credit terms would tighten considerably for many family farms, with a disproportionate impact on the most distressed farms most in need of credit. Therefore, the proposed increase in the Chapter 12 debt limit to $10 million in H.R. 2336 is not needed and would increase borrowing costs and decrease the availability of credit for farmers in need of credit.

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[2] https://www.extension.iastate.edu/agdm/wholefarm/html/c1-10.html

[3] https://www.nebraskafarmer.com/management/report-average-farm-debt-rises-over-13-million