

# VIRGINIA BANKERS ASSOCIATION

VBA COMMITTEES

## Agenda

Legal Affairs Committee Meeting  
Monday, March 4, 2024  
10:30 a.m. – 12:00 p.m. | Virtual (Zoom Meeting Information Below)

### *Legal Affairs Committee Mission Statement*

*To enhance the ability of the Association and its member banks to respond to legal challenges affecting banking in Virginia. To this end, the Committee shall identify and review legal issues of concern; assist in developing legislative, regulatory, and judicial initiatives; and otherwise serve as a forum for the dissemination of information concerning legal developments impacting banks in Virginia.*

- I. **Welcome - Lowell “Bud” H. Patterson, III, Chairman**
- II. **Open Roundtable**
- III. **General Assembly Update – Matthew Bruning, EVP, VBA, Government & Member Relations**
- IV. **Adjourn**

### Zoom Link to Meeting:

<https://us02web.zoom.us/j/83838776728?pwd=T1FXVU1aOUVENW0yOGIYaE5TSzVWUT09>

Meeting ID: 838 3877 6728

Passcode: 689593

### 2024 Meeting Dates:

**March 4<sup>th</sup> (virtual), May 20<sup>th</sup> (in person), September 9<sup>th</sup> (in person), December 2<sup>nd</sup> (in person)**

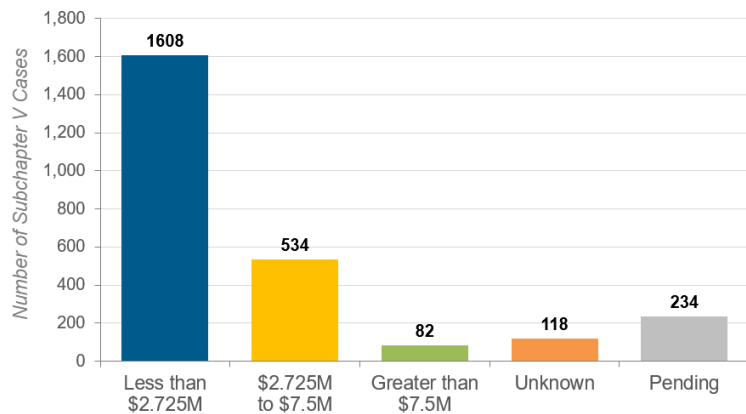
## Unintended Consequences of Bankruptcy Reform

History demonstrates that, while well-intentioned, pro-debtor bankruptcy reform would come at the expense of higher costs and lower credit availability for borrowers. Increasing thresholds for bankruptcy eligibility undermines loan quality for lenders and requires that they raise interest rates and fees and tighten credit standards. This restricts access to credit, particularly for lower-income and underserved borrowers who already face challenges obtaining credit.

### Majority of cases already qualify

The vast majority of small business cases would have qualified for the Subchapter V “fast track” process even if Congress had not raised the debt limit in the CARES Act. Out of 2,224 Subchapter V cases filed between August 1, 2021 and April 30, 2023 with known debt levels, over 70 percent qualified under the \$2.725 million statutory limit.

### Majority of Small Businesses Already Qualify for Subchapter V “Fast Track” Process



Source: AIS InfoSource, based on 91% sample of cases filed between August 1, 2021 and April 30, 2023

### Increased bankruptcy eligibility increases credit costs and reduces access

[A report](#) found that when small businesses are located in states with generous exemptions that shield assets from creditors, they are 32% more likely to be turned down for credit than for firms in states with more strict exemption laws. When they did receive loans, interest rates were higher (by as much as 2.2 percentage points) and loan amounts were smaller than for borrowers in states with stricter laws. Finally, the report found that small businesses with lower net assets (a proxy for wealth) were more likely to be turned down than firms with higher net assets in states with more lenient laws.

These results were corroborated by a [recent report](#) that found that higher property exemption limits reduced credit availability for small businesses and that the effect was strongest for the smaller, more financial constrained businesses. This led to fewer establishments and lower wages for employees, “particularly for small businesses with less than five employees.”

Interest rates are increasing, and Congress should not make changes to the bankruptcy laws that would make credit for small businesses more expensive and less available. Caution is especially important as the banking regulators have proposed new rules that would require larger banks to set aside significant amounts of capital to guard against interest rate and other risks. This could reduce lending for businesses of all sizes. The new capital rules, combined with the proposed changes in small business bankruptcy law would create a “perfect storm” that worsens credit availability for small businesses.



October 23, 2023

Members of the Subchapter V Task Force  
American Bankruptcy Institute  
66 Canal Center Plaza  
Suite 600  
Alexandria, VA 22314

Dear Members of the Task Force:

The American Bankers Association (ABA)<sup>1</sup>, and the Independent Community Bankers of America (ICBA)<sup>2</sup>, are providing this statement as our joint industry views on the challenges lenders face associated with the operation of Subchapter V of the Bankruptcy Code.

### **Overview**

We believe it is vitally important for bankruptcy policy makers in Congress to consider the costs and benefits of any bankruptcy law change to *all* stakeholders. Importantly, these stakeholders include not just trustees, judges, debtors, and creditors. The largest stakeholder community, which is often ignored, is the larger population of borrowers – whether business borrowers in the case of Subchapter V or consumers. It is well accepted by industry participants that elevated risks of default and non-payment are related to both the cost and availability of credit in general.

In the context of Subchapter V, the law is too new for our members to confidently assess the true effect on credit availability to small businesses. However, if Subchapter V eligibility requirements are liberalized further or the temporary, COVID-era changes are made permanent, it is likely that non-bankrupt, solvent small business will confront tighter and more costly credit requirements. Such an outcome would slow small business growth and could trigger additional and unnecessary business failures.

In the current economic environment, bankruptcy law changes that would restrict access to credit for small business would be doubly unwise. The Federal Reserve has launched a nearly unprecedented

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<sup>1</sup> The American Bankers Association is the voice of the nation's \$23.5 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2.1 million people, safeguard \$18.6 trillion in deposits and extend \$12.3 trillion in loans.

<sup>2</sup> The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding \$5.8 trillion in assets, \$4.8 trillion in deposits, and \$3.8 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).

increase in interest rates, which is impacting the cost and availability of credit. The proposed changes in small business bankruptcy law would create a “perfect storm” that worsens credit conditions for small businesses. Based on recent feedback we have received from lenders that are our member institutions, it would be beneficial to both debtors and creditors for business owners to be required to invest new capital in order to use Subchapter V. This is of concern to many lenders as the number of Subchapter V cases are increasing in certain parts of the country. Many lenders also believe that the increased debt limit was intended to be a temporary measure and should be permitted to expire.

### **Problematic Provisions of Subchapter V**

Public policy choices frequently involve trade-offs. This is true of Subchapter V as well. The fundamental choice made by Congress when originally enacting Subchapter V was to speed the bankruptcy process for the smallest of small businesses by eliminating certain paperwork requirements and severely curtailing the rights of creditors.

As noted by our members, the elimination of the absolute priority rule and the right of creditors to vote on a plan of reorganization removed key oversight and accountability mechanisms. Under Subchapter V as originally enacted, the actual effect on lenders should in theory be limited. However, as the Task Force knows, Congress dramatically raised the debt eligibility limits to \$7.5 million during the COVID pandemic. It is too soon to tell whether expanded Subchapter V has achieved its goals. It is reasonable, however, to conclude on a preliminary basis, based on time-tested standards that examine bankruptcy risk and credit standards, that Subchapter has or will result in burdens on small businesses generally. In our view:

- The temporary increase in the Subchapter V debt limit should be permitted to expire.
- The manner in which debt is calculated for purposes of Subchapter V should be revised to include insider debt to avoid the obvious misuse of this fast-track process to circumvent accountability.
- The GAO or a similar non-partisan entity should be tasked with reviewing the effectiveness of Subchapter V
- Factors to consider in such a review should include how many plans fail to confirm, how many plans fail after a confirmation and the effect of Subchapter V on credit conditions for otherwise solvent small business to include the perspective of risk management professionals who operate inside small business lenders.

### **Conclusion**

In the current economic environment – increased borrowing costs, capital constraints due to regulation and the possibility of a recession – it is crucial that policy makers in Congress intensely focus on fostering an environment where small businesses can flourish. We believe that the costs and burdens on small businesses would greatly outweigh any speculative benefit from liberalizing Subchapter V such as making the temporary \$7.5 million threshold permanent.

Thank you for considering our views.