
CONSUMER FINANCE PODCAST: NEW CONSUMER BANKRUPTCY REFORM ACT IMPLICATIONS AND THE 2023 CONGRESSIONAL OUTLOOK

Chris Willis:

Welcome to The Consumer Finance Podcast. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice. I'm really glad you joined us today for our episode on the Consumer Bankruptcy Reform Act, and a discussion of the legislative outlook for the lame duck session and the next Congress. But before we dive into those topics, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com, where you'll see daily updates about everything that's going on in the world of consumer finance. And don't forget to check out our other podcasts; we have lots of them. We have [FCRA Focus](#), all about credit reporting; [The Crypto Exchange](#), which is of course devoted to crypto; and [Unauthorized Access](#), which is our privacy and data security podcast. All of them are available on all popular podcast platforms. And speaking of those platforms, if you like our podcast, let us know. Leave us a review on the podcast platform of your choice.

Now, as I said, today we're going to be talking about a new piece of federal bankruptcy legislation that's pending called the Consumer Bankruptcy Reform Act. We're going to go into what the implications of that might be for consumer lenders. Then we're also going to talk about the general legislative outlook and the outlook for financial services in the lame duck session of Congress and in the next Congress following the 2022 midterm elections.

I'm really happy to be joined by two of my colleagues who I'm very proud to introduce you to. So first, our first guest is going to be Deb Kovsky. Deb is a partner in our bankruptcy group, and she has a lot of expertise in consumer bankruptcy matters and advises our consumer lender clients on issues related to consumer bankruptcy. We also have Tom Tilton on the show with us today. Tom is with our subsidiary, Troutman Pepper Strategies, which is an affiliate of our law firm that represents clients in government relations matters on the Hill and with the administration. Tom himself is a former congressional staffer who's now a lobbyist and spends a great deal of his time in the financial services space. Deb, Tom, thanks a lot for being on the show today.

Deb Kovsky:

Hey Chris, thanks so much for having me.

Thomas Tilton:

Happy to be here, Chris. Thank you.

Chris Willis:

Well, it's a real treat to have the opportunity to introduce both of you to our audience today. But Deb, let me start with you. There's this new or sort of new legislative proposal that would have a pretty significant rework of consumer bankruptcy practice called the Consumer Bankruptcy Reform Act. Can you start off by just telling the audience what is it?

Deb Kovsky:

The CBRA is really Elizabeth Warren's brainchild. It's something I am sure she's been thinking about since she was a professor teaching bankruptcy in law school. It was originally introduced back in 2020. It kind of went nowhere, and then was reintroduced this year in September in both

the Senate and the House. And what the CBRA is intended to do is really just to completely revamp consumer bankruptcies. It would get rid of Chapter 7 for consumers, Chapter 13 would be repealed completely, and instead we would get this brand-new Chapter 10. And no, by the way, I have no idea what happened to Chapter 8 or why it got skipped, but we're going to go straight to chapter 10, which would basically combine some of the elements of both Chapter 7 and chapter 13, while at the same time trying to streamline the process and make it somewhat easier for consumers to discharge their debts.

One of the things really interesting about it is that it allows for what are effectively limited bankruptcy proceedings. You can go into bankruptcy without going all the way in. The way that works is there's three different types of plans that a consumer debtor can propose, and they could actually propose more than one if they needed to based on the circumstances.

One type of plan is a repayment plan, and that solely provides for treatment of unsecured claims. The CBRA looks at whether the consumer is what I'll call a can pay or a can't pay. They figure that out by looking at the sum of the debtor's non-exempt assets if they have any, and then there's a progressively graduated percentage of annual income exceeding 135% of the state median income. And that calculation is what the CBRA calls the minimum payment obligation.

Now if that's zero, the debtor just gets an immediate discharge, very similar to a Chapter 7, they just go on their way. But if it's a non-zero number, then the debtor needs to file a repayment plan that provides for distribution to creditors of that minimum payment obligation over a period of up to 36 months. But the minimum payment obligation actually can be reduced by the court under a variety of circumstances. The debtor gets an immediate discharge on confirmation of the plan, not on completion of actual payments under the plan. And if the debtor defaults on plan payments, discharge doesn't get revoked. So that's one way to go into bankruptcy just with respect to your unsecured debts.

Then the second type of plan is a residence plan, which as it sounds like provides for the treatment of claims that are secured by the debtor's principal residence.

And then there's a third type of plan called a property plan that solely provides for treatment of claims that are secured by property that's not the debtor's principal residence, so think vehicles or boats. And as you can imagine, the bill is intended to be very friendly to consumer debtors. If it's passed, the statute would actually tell courts how to understand any provisions that may be unclear or unambiguous, and the courts are to understand them in favor of the debtors. The interpretive principle of the bill, which is actually found at section 1010 of the bill, provides that, and I'm going to quote from it, "In cases under this chapter, the provisions of this title shall be interpreted liberally in favor of relief for consumer debtors."

So this is a bill that if passed is going to really slant consumer bankruptcies to the greatest extent possible in favor of consumer debtors and against providers of credit.

Chris Willis:

Okay, Deb, so that being the case, and I guess a lot of the public dialogue around the CBRA has focused on what you just said, which is it makes it better and easier for consumers to get discharges and to avoid consumer debts, but when you squeeze one end of the balloon, the other end blows up. So we probably should consider, and I'd love you to comment on, what might be the potential impact of this on lenders and other credit providers whose debts are now subject to much easier discharge under the CBRA if it becomes law?

Deb Kovsky:

I love that analogy of squeezing a balloon and seeing the other end blow up, because really in a sense, this is the pendulum swinging back after the 2005 amendments to the Bankruptcy Code, which were seen as being very creditor friendly. There are probably four or five main areas where credit providers are going to want to pay special attention to this bill. A big area is educational loans. Currently, Section 523(a)(8) of the Bankruptcy Code, that's a section that most people are familiar with, even if they don't know the section number because that's the provision that makes it really difficult to discharge most student loans in bankruptcy, absent of showing of what's called undue hardship. And most courts have interpreted that to be a really high bar. The CBRA just strikes that provision altogether. So student loans would be fully dischargeable, just like credit card debt.

Another part of the CBRA with an obvious impact on lenders would be with respect to mortgages. The residence plan, which we just talked about briefly, it allows for loan modifications, it provides for the curing or waiving of any default up until any time that the debtor ceases to have rights, including a right of redemption in the property. And in some states that could be a year. And you can compare that with a current Chapter 13, which cuts off the cure period at the time of a foreclosure sale. So that's a big difference. And the amount to cure cannot require interest on [inaudible 00:07:45] or the payment of any penalty rate, late fee, or payment required under a penalty provision of the loan documents.

So that's, I think, a pretty significant change and something that would impact lenders. The debtor will not be deemed to be in default under a residence plan for late payments until they're at least 120 days delinquent. And the plan can stretch maturity of the loan so that the last payment on account of the secured claim is due by the later of 15 years after confirmation of the residence plan, which remember is going to happen at the time that the bankruptcy is filed, or five years after the original maturity date of the loan. So, there could be a pretty significant stretching of maturity of these loans.

So, there are a lot of modifications, even if the provision that allows for loan modifications is not interpreted to allow for non-consensual modifications. And I have to say, that's not clear from the text of the statute. There are still some modifications built in here that are very consumer friendly and very, let's call them, lender unfriendly. So, I think these are really just material changes that make it harder for mortgage lenders to get the benefit of their bargain or to exercise their rights in their collateral.

Chris Willis:

It seems kind of obvious from everything that you're saying, Deb, that the effect of the bill would be to increase credit losses for consumer creditors, not just in mortgage transactions, but in all kinds of credit transactions. And so it seems to me, again, using the squeezing the balloon analogy, if you squeeze that end, then the other end has to react by either restricting the availability of credit to reduce the number of bankruptcies in the portfolio, or to price it to take that risk into account, which is higher than the pricing would be without that. Seems to me it's just a recipe for making credit less available and more expensive.

But let's go back to educational loans for a minute, because that's very interesting to me. It's obviously a hot topic right now because of the Biden administration's efforts to cancel significant amounts of student debt for a good swath of borrowers. What would prevent, if this CBRA becomes law, every college student from just filing for bankruptcy and discharging their student debt right after they graduate?

Deb Kovsky:

Ironically, that's exactly why 523(a)(8) was passed in the first place to address specifically that type of abuse. Whether it was actual, perceived, how widespread it was can be debated, but there really aren't a lot of guardrails to prevent exactly that outcome from happening. The CBRA, by getting rid of Chapter 7, gets rid of the means test, so somebody who wants to file for bankruptcy doesn't have to prove that they're entitled to a discharge in a Chapter 7 type of scenario. They can file a limited plan that only addresses unsecured claims, so it leaves the rest of their assets out of the bankruptcy to all intents and purposes.

Another aspect of the CBRA is that it doesn't look at what a debtor's expenditures are. The current bankruptcy regime puts some brakes on what may be seen as excessive or luxury spending by debtors. There's none of that in the CBRA; it's just the ability to pay the minimum payment amount.

A debtor could go in, have very little impact on their daily life, on most of their assets, get rid of their unsecured student debt, and go on their merry way. And I think that there is good chance that's precisely what would happen. If this bill is passed in the form that it's currently proposed in, it's almost like students are being invited to do that.

The problem is that President Biden's Loan Forgiveness Program, Senator Warren's CBRA, they're both band-aids that don't address the underlying problem. The problem is the cost of higher education. Students are going to have to continue to borrow in order to be able to go to college, and putting them in a position where they're being encouraged to both borrow money to finance their education and then turn around and discharge those loans immediately in bankruptcy, it's basically shifting the entire problem onto the backs of education lenders instead of addressing the real issue.

Chris Willis:

Deb, one question. This discussion you've been having about the dischargeability of education loans, would that also apply to federal Title IV loans? Or would it just be private education loans?

Deb Kovsky:

There's no distinction that's made in the CBRA. Any student who borrows money to go to college, there's no distinction even between qualified educational expense and other types. The entirety of 523(a)(8) which draws all those distinctions and puts all of those different limitations in on various types of student borrowing, that's all gone. It's repealed in its entirety under this proposed bill.

Chris Willis:

So the impact isn't just on the backs of lenders, it's also on the backs of taxpayers with respect to Title IV loans, and those are 90 something percent of the student loan market. So that has a lot of taxpayer impact as well, it sounds like.

Deb Kovsky:

It's a lot of cost shifting in a way that doesn't necessarily make sense. As I said, it's a band-aid on the underlying problem.

Chris Willis:

Okay. That is fascinating. Tom, let me turn to you. I mean, you've just heard Deb tell us about this seemingly to me extreme change in consumer bankruptcy. And so, it's sort of natural for us to ask, "All right, well, what does Congress look like?" So we can think about whether something like this might get through and become enacted or not. Can you just start off by commenting for our listeners about following the 2022 midterms, and given what happened there, what do we expect? First in the lame duck session that Congress is in now, and then once the new Congress is constituted, giving effect to the midterm elections. What do you see as a legislative outlook?

Thomas Tilton:

Congress likes nothing more than deadlines, and the end of the year always provides that. A lame duck with a midterm election will always characterize how that takes shape, and definitely did in this case. Democrats were able to hold the Senate, but the House obviously flipped to Republicans. And so that really will characterize and has characterized how Republicans have negotiated with the big elephant in the room, and that's the omnibus spending bill and appropriations, which will also act as a vehicle.

There's one other kind of legislative vehicle out there, the National Defense Authorization Act, or the NDAA as you might hear it referred to. That is being voted on either later today or tomorrow morning by the Senate, but two versions: one with permitting reform attached, the other with not. That's something that's being pushed by Senator Jim Manchin. That's something that's kind of characterizing how narrow the majorities are currently, but the majorities are going to remain narrow.

For the omnibus and negotiations, they reached an agreement this week, \$1.7 trillion in a top line, and that includes defense and non-defense spending. That's all 12 appropriations bills in the omnibus. That aligns mostly with Biden's budget actually, but it has an increase for defense.

Republicans in the House are not a part of those negotiations. Kevin McCarthy, who is hoping to be speaker and is still seeking the votes, has chosen to remain outside of that as well as the Republicans on appropriations. They are saying that this bill should be a short-term CR and that they should deal with it in the new year and reflect the vendors' wishes. McConnell, and I think the vast majority of Republicans, whether they want to say it or not, might be hoping to actually get this done so they don't have to deal with the political consequences of a potential shutdown in the new year.

Right now we are seeing what will probably be a one week CR and most expect maybe by Monday, this coming Monday, for the House and Senate to reveal a compromised bill with potential language and details below that top line. That will hopefully have fiscal year 2023 funding resolved.

That's kind of how we see the lame duck right now. The lame duck will be by and large also characterizing some of what the new Congress will deal with. There's some things that are not going to make that omnibus bill or the NDAA, and not going to be able to catch that ride to passage. That includes the permitting reform on NDAA already mentioned, but it also includes other issues that are bipartisan in nature, by progressives or conservatives leverage policy issues against each other all the time, and that's happening on tax issues.

The R&D dispensing issue is a big one that businesses have been looking to. Democrats remain committed to extending the Child Tax Credit. Those two are being leveraged against one

another, and House Republicans will have to find a way to address that, as will Senate Democrats in the new Congress.

Those are some of the other things. There are a host of other tax issues that will remain unresolved. And the narrow majority in a new Congress, the 118th, will be by and large characterized by House Republicans enforcing oversight and investigation with the Biden administration. They will be playing up ESG concerns. They will be looking at the tax items already mentioned. They'll be looking at energy priorities and other healthcare priorities.

There are some bipartisan possibilities, I would say, in the new Congress, that would include taking a look at Big Tech antitrust issues. Republicans and Democrats or each critical of Big Tech for a variety of reasons. Sometimes they differ, but they can find agreement potentially. China remaining an issue can be a bipartisan issue on trade and security. Privacy concerns, the bipartisan larger scale National Data Privacy Agreement will not find its way into any final bill this year. The Kids Online Safety Act, which would provide a narrower set of privacy guidelines and safeguards for children, might still find final passage this year. But again, those are things that can be bipartisan.

Chris Willis:

Thanks, Tom, for that general overview of what we can expect in the near term in Congress and next year. What about the outlook for financial services type issues? That of course is what our listeners are most interested in. I'd love to hear your comments on that.

Thomas Tilton:

Absolutely. I think there are a couple things that could be bipartisan, and then some that could be highly partisan in the new Congress. I've already mentioned ESG. Obviously, the SEC has guidelines that they've put out, and Gary Gensler will be summoned before the House Financial Services Committee, and incoming Chairman McHenry in the new year, he has been told that through press releases and otherwise. That will definitely be an area that House Financial Services Committee looks to grill him on, as well as enforcing oversight with the CFPB in a variety of areas.

One area that's obviously front and center in the news at the House Financial Services Committee and at the Senate Banking Committee is the bankruptcy of FTX and the investigations there and obvious arrests and charges of Sam Bankman-Fried. House Financial Services Committee hosted the new CEO, I guess I would say, the bankruptcy CEO of FTX, and Senate Banking did its own hearing as well on the issue.

That really kind of plays into what Congress has been looking at. The Senate had been very cheerfully studying the Digital Commodities Consumer Protection Act, or the DCCPA, which received a lot of criticism, especially in the past month, because Sam Bankman-Fried had spent a lot of time providing input. That bill would look to give the CFTC authority and oversight and funding to provide that oversight of digital commodities into the future. That bill was already pulled essentially by its authors to be reevaluated, and is a bipartisan bill sponsored by Senators Stabenow and Barrasso, but expect it to be retooled and possibly renamed the Digital Commodity Exchange Act to give it some fresh feel away from its prior input from industry.

Future Chairman McHenry has been focused on stablecoin legislation, and he has been intent on making it a bipartisan approach. It's something that he feels needs legislating and something we expect him to maintain as a priority in the new year and try to build bipartisan support on a final bill. Outside of his oversight targets of the SEC or the CFPB, we think he'll be focused on

making it easier for companies to raise capital. People believe there should be more public companies, and securities laws disadvantage minorities as well. So, he has been looking in previously proposed SEC exemption for small businesses. Some other areas could be including GLBA expansion for consumer data.

Those are just some of the areas it's rapidly evolving, especially in the cryptocurrency space or the stablecoin space. We expect that to continue to evolve. But future Chairman McHenry is very much a policy [inaudible 00:20:18]. He's a serious chairman. We believe he has a set of serious issues he plans to take a look at, and has been preparing for well over a year for some of these hearings that we'll see in the new year.

Chris Willis:

Thanks a lot, Tom. And if I just add my own comment, it seems to me that the outlook for passage of a bill like the CBRA that Deb and I were talking about a minute ago to sort of radically reshape consumer bankruptcy in a very consumer friendly and credit or hostile way, seems like something that would be difficult to see passing the new Congress with the even narrow Republican majority in the House, even if the Democrats all could get behind it, which I don't even know whether that would be the case or not. So, I'm at least hopeful that the list of provisions that Ted shared with us earlier in the podcast at least won't come true anytime soon. Of course, I've got my fingers crossed for that. So we'll see what ends up happening in that regard.

Thomas Tilton:

I think that's a strong characterization. Something has to be built from the ground up in a bipartisan manner with these narrow majorities, and especially in a divided Congress, to really have life in the new year.

Chris Willis:

Yeah. Thank you for that. Tom, thank you for being on the podcast, and thank you for giving me the opportunity to introduce Troutman Pepper Strategies, our lobbying group, to our listeners of this podcast. And Deb, thank you for being on the podcast, too. Your bankruptcy expertise is always invaluable to our clients, and I'm really glad that you took the time to be on today's program.

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