Testimony of

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The National Bankruptcy Conference (the "Conference") appreciates the opportunity to participate in these hearings on financial regulation reform. The Conference is a voluntary, non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

The Conference understands that, given the turmoil in the capital markets following the collapse of Lehman Brothers and the concerns expressed about whether the existing tools available to the federal government are sufficient to address systemic risk following the possible collapse of one or more other large financial institutions in the future, the federal government should have additional tools available to it. In fact, the Conference supports the promulgation of a statutory and regulatory resolution scheme by which federal regulatory agencies would be able to identify a large financial institution (an "identified financial institution") and its affiliates whose collapse would threaten U.S. and international capital markets and by which, in the face of an imminent collapse of the identified financial institution and its affiliates, a federal agency would be equipped and have the power to rescue the core business of the identified financial institution and its affiliates with a view to mitigating or even eliminating that risk.

However, the Conference also believes that whatever resolution scheme is devised must (a) be transparent as to which financial institutions would be subject to the resolution scheme, (b) create certainty for extenders of credit to the identified financial institution and its affiliates by establishing clear rules that would apply to the scheme and (c) provide rules which are fair to creditors of the identified financial institution and its affiliates. Otherwise, credit would be less likely to be available to a financial institution and its affiliates that could be subject to the

resolution scheme or would be less likely to be available at a lower price. In the absence of credit being available or being available at lower price, the Conference is concerned that the financial distress of the financial institution and its affiliates will only be exacerbated, and the risk of a collapse of the financial institution and its affiliates and the systemic risk following that collapse will only be greater.

The Conference expresses this concern, because in its experience many debtors currently eligible for relief under the Bankruptcy Code often avoid bankruptcy by receiving sufficient credit to address immediate needs in the short term and, in the longer term, to achieve rehabilitation outside of bankruptcy. When credit is so extended under these circumstances, often bankruptcy is avoided. If credit that a debtor requires to meet short term needs and to rehabilitate itself is not be available or is available only at a price that makes rehabilitation unworkable, there is a much larger risk that bankruptcy will be inevitable.

Discussed below are the elements of transparency, certainty and fairness that the Conference believes should be considered as an integral part of any such resolution scheme in order not to discourage the extension of credit at manageable rates.

Transparency as to those subject to the resolution scheme

Those extending credit to a financial institution and its affiliates will need to know, before extending credit, whether the financial institution is an identified financial institution. Whether the financial institution is an identified financial institution will be a critical factor that any extender of credit to the financial institution and its affiliates will want to consider in deciding whether to extend credit to the financial institution and its affiliates and on what terms.

An extender of credit will invariably take into account the risk that its debtor will not be able to repay the credit extended. It will make the credit available and price the terms of the

credit based on the statutory and regulatory scheme by which the debtor will be rehabilitated or liquidated if it becomes unable to pay its debts. For example, a lender extending credit to a borrower who is eligible to be a debtor under the Bankruptcy Code will make credit available to the borrower and will price the terms of the credit based on the bankruptcy rules that would apply in the event that the borrower became a debtor under the Bankruptcy Code.

If an extender of credit to a financial institution and its affiliates does not know whether the financial institution is an identified financial institution, it will not know what rules would apply if the financial institution or one of its affiliates experiences financial distress to the point where it must be rehabilitated or liquidated. The result would likely be that the credit extender would need to take into account in its credit decision the possibility that either the resolution scheme for identified financial institutions would apply or the more traditional bankruptcy and insolvency rules, such as those in the Bankruptcy Code, would apply. The multiple sets of rules that might apply in the case of the financial distress of the financial institution and its affiliates would require the extender of credit to examine each set of rules and to base its credit decision on the rules in each scheme that are least favorable to the extender of credit. This approach would likely lead to less credit being extended to the financial institution and affiliates or, if credit is extended, higher pricing and in any event greater transaction costs. And the result would be the case even for a financial institution that is not an identified financial institution, or for one of its one its affiliates. if it appear to extenders of credit as if the financial institution *might* be an identified financial institution.

Accordingly, the Conference urges that the resolution scheme to rescue or liquidate identified financial institutions contain a mechanism by which it will be publicly known whether a financial institution is an identified financial institution. The Conference also urges that the

resolution scheme contain a mechanism by which there is advance notice to the public when a financial institution becomes or ceases to be an identified financial institution.

The Conference recognizes that, if a financial institution becomes an identified financial institution after credit is extended to the financial institution or one of its affiliates, the core salutary value of the advance notice that the financial institution is an indentified financial institution will not be as great. The credit decision by the extender of credit will already have been made. But advance notice to the public that a financial institution has become an identified financial institution will still enable the market to adjust over time. The extender of credit will have the opportunity to modify the terms of the credit, if so permitted, or to crystallize its position by selling the credit to a buyer at a price that adjusts for the credit risk.

In any event, to the extent that a financial institution is already subject to prudential regulation, the advance notice of a financial institution being designated as an identified financial institution may be easier to effect and, indeed, may be more predictable to the market.

Certainty as to the rules that would apply

It is not only necessary that those extending credit to a financial institution know whether the identified financial institution is an indentified institution. They will also need to know with certainty, before extending credit to an identified financial institution and its affiliates, what rules will be applied to the rescue or liquidation of the identified financial institution and its affiliates should a rescue or liquidation become necessary. To the extent that the rules are unclear or underdeveloped, the extender of credit will be uncertain what the rules are and how they will be applied. That uncertainty will also likely decrease the availability and increase cost of credit to the identified financial institution and its affiliates.

The Conference raises this issue primarily with respect to the claims resolution process affecting creditors of an identified financial institution and its affiliates. Once the core, systemic risk related assets of an identified financial and its affiliates are transferred under the resolution scheme to a buyer or to a bridge entity, some assets and unassumed liabilities will invariably be left behind.

There will be significant uncertainty for creditors of an identified financial institution and its affiliates if the creditors will be subject to two different claims resolution sets of rules, including different priority rules, depending upon whether an identified financial institution and its affiliates are the subject of a federal intervention or are debtors in bankruptcy cases without federal intervention. Applying the rules in the Bankruptcy Code for liquidating the assets left behind and distributing the proceeds of the liquidation to creditors of the identified financial institution and its affiliates whose liabilities are not assumed in the transfer would eliminate that uncertainty. There would be one set of rules that would apply for the claims resolution process regardless of whether the identified financial institution and its affiliates were subject to federal intervention or were debtors in bankruptcy cases without federal intervention.

Even beyond avoiding the possible application of two different sets of rules for the resolution claims process, certainty would be more likely to be achieved by using the Bankruptcy Code rules for the claims resolution process. The Bankruptcy Code rules are more detailed than those applicable to a federal bank receivership. For example, the preference rules in the Bankruptcy Code consist of a well detailed section, Bankruptcy Code § 547, that contains the elements of a preference as well as the defenses to a preference claim. Section 550 of the Bankruptcy Code explains against whom a preference claim may be made. Similar details are lacking in a federal bank receivership where the only preference rule is one based on an intent to

prefer. Like concerns exist in the area of secured claims, the computation of the amount of claims, fraudulent transfers, executory contracts and priorities where the Bankruptcy Code rules are much more detailed compared to the rules of a federal bank receivership.

The Bankruptcy Code rules are not only more detailed than those for a federal bank receivership. They have also been stress tested by a very large body of judicial interpretations. This is much less the case for the rules of a federal bank receivership since claims resolution procedures are administrative and the opportunity for judicial review is much more limited.

Furthermore, the rules of the Bankruptcy Code are well known to judges and to lawyers and other professionals. The Bankruptcy Code and its rules of procedure are widely published, are interpreted by published cases, are studied in law schools and are the subject of numerous periodicals. This is not nearly the case for rules of a federal bank receivership.

It is understandable that the rules for a federal bank receivership as not as detailed, well developed or well known as those applicable to federal bankruptcy case. In most federal bank receivership, once depositors are paid, there are few, if any, assets left to pay general unsecured creditors. As a result, there has been less of a need for the rules of a federal bank receivership to be as detailed, developed and well known as the rules applicable in a bankruptcy case. But under the resolution scheme being considered there may be substantial assets of an indentified financial institution and its affiliates left behind to be liquidated and distributed to the creditors of the identified financial institution and its affiliates. The need under this scheme for the rules to be detailed, well developed and well known is much more acute if greater certainty for creditors is to be achieved. The Conference believes that the Bankruptcy Code rules, being detailed, well developed and well known, already provide that greater certainty.

Fairness to creditors

The rules by which creditors are treated when a financial institution and its affiliates are rescued or liquidated must be fair. If the rules are regarded as unfair, there will be much less of a willingness for credit to be extended to identified financial institutions and its affiliates or for credit to be extended at cheaper rates.

The Conference regards the Bankruptcy Code rules for resolving claims against an indentified financial institution and its affiliates as being inherently more fair than those applicable to a federal bank receivership. This is certainly true merely because the Bankruptcy Code rules are more detailed, developed and well known than the rules for a federal bank receivership. But it is also true with respect to the standards used in claims resolutions. In an administrative process, the administrator is given broad latitude in making decisions short of acting in an arbitrary or capricious manner. Under the Bankruptcy Code the bankruptcy judge applies the law and the facts and can be reversed by an appellate court on the merits even though the bankruptcy judge had not acted in an arbitrary or capricious manner.

Speed of resolution is also a factor in fairness. A creditor whose claim is resolved quickly will feel more fairly treated than a creditor whose claim is resolved only after a lengthy process. The Conference believes that the Bankruptcy Code procedures are more likely to resolve claims quickly than an administrative process. With an administrative process the creditor will need to exhaust administrative remedies before seeking judicial intervention. Under the Bankruptcy Code judicial intervention is available at the outset.

There is also the view that the Bankruptcy Code claims resolution process is fairer because it is more transparent. Claims are litigated in open court and with a public record. Each creditor has an opportunity to observe how other creditors are being treated and to make its case to the court if its believes that is not being treated fairly with respect to other creditors. This is

may be less true for administrative procedures associated with a federal bank receivership where proceedings are not as public and the record of the proceedings is not as accessible.

There is one other fairness issue that merits discussion. While some compromise of a creditor position may be necessary for the greater good of the financial system, the compromise should not be without limits. In a Chapter 11 case under the Bankruptcy Code a plan of reorganization cannot be confirmed over the objection of a single creditor if that creditor is not receiving as much under the plan as it would receive if the debtor were liquidated a Chapter 7 case. This provision is grounded in a notion of fundamental fairness, with Constitutional implications.

As matter of fundamental fairness, there should be similar limited protection for creditors of an identified financial institution and its affiliates. The resolution scheme should not be used in such a way so as to deprive a creditor of what the creditor would have received had the identified financial institution and its affiliates been liquidated without federal intervention under the scheme. The resolution scheme should provide a mechanism for making the determination of what the creditor would have received in a liquidation of the identified financial institution and its affiliates and for compensating the creditor to the extent that the creditor is receiving less under the resolution scheme.

Conclusion

Without the resolution scheme providing these elements of transparency, certainty and fairness, the Conference is concerned that credit will be less available to identified financial institutions and their affiliates or will be available at a higher price and that, as a result, the very risks that the resolution scheme wishes to avoid will be more likely to occur.