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Provisions of S.413 and H.R.1278 that Would Discourage the Extension of Credit to the Thrift Industry

The Bush Administration's proposed legislation to resolve the thrift crisis (S.413, H.R.1278) contains several provisions that would greatly expand the powers of receivers and conservators for failed banks and thrifts against the creditors of those financial institutions. The legislation would grant receivers (e.g. FDIC) of financial institutions significant powers to impair creditors' contractual rights; some of these new powers would mirror Bankruptcy Code provisions previously inapplicable to banks and thrifts, but some of them go well beyond the powers of a Bankruptcy Code trustee. The effect of these provisions would be to discourage the extension of credit to thrifts, or, at a minimum, to raise the cost of credit to thrifts substantially. Some of the "problem provisions" of the proposed legislation that would eviscerate thrift creditors' rights are outlined below:

1. Receivers and conservators (collectively "Receiver") can enforce contracts notwithstanding ipso facto clauses (Sec. 211(2)).

2. Receiver can disaffirm contracts with "no liability" (Sec. 211(2)).

3. The powers in 1. and 2. above create the potential for "cherry-picking" (i.e. some contracts would be assumed, others rejected or "left behind" in a bridge, bank or other transaction) and impairment of netting and set-off rights of creditors. The discretion afforded FDIC as to assets and liabilities also creates potential for "cherry-picking" (Secs. 211(2), 211(7), 211(8)).

4. The discretion afforded FDIC as to assets and liabilities also creates the potential for "depositor preference."

5. The receiver can obtain 90-day stay of "legal" proceedings and "actions" (Secs. 211(2), 211(8), 214(3)).

6. Claims procedures could apply to creditor self-help remedies such as foreclosure on collateral and exercise of netting and set-off rights (Sec. 211(2); Sec. 211(10)), thereby weakening creditor remedies.

7. The "grandfather" provision would not seem to cover prior FHLBB/FDIC "comfort" given to creditors as to rights against a Receiver (Sec. 402): it creates uncertainty as to whether the prior "comfort" provided (i.e. "repo resolutions" and "Raiden letters") regarding substantive consolidation of subsidiaries, treatment of asset sales (with or without recourse), liquidation of collateral, treatment of letters of credit, American Savings and Loan resolutions will continue.

8. There is the potential for non-uniform treatment and uncertainty created by incorporation of other federal laws (Sec. 211(3)) and state law receivers' powers (Sec. 211(4)). Incorporation of other laws raises potential for avoidance of ordinary course mark-to-market transfers as preferences or fraudulent conveyances.

9. It is unclear how the written agreement requirement (Secs. 211(8), 214(4)) would apply to netting and set-off rights, or amendment of agreements.

10. Cross-guarantee liabilities (Sec. 206(5)) would be superior to "contingent" liabilities. It is unclear what liabilities are "contingent."

11. The provisions empowering the Receiver to assign assets and liabilities without consent cannot override contrary regulatory schemes (futures).

Moreover, the Supreme Court decision announced March 21, 1989, in Coit Independence Joint Venture vs. FSLIC, appears at first glance to call into question certain procedural and substantive aspects of the thrift receivership regime. PSA will suggest appropriate changes in the proposed legislation, if necessary to remedy the problems noted above as well as the Supreme Court's holding in Coit.

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