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Consumer bankruptcy is intended as a debt collection mechanism for creditors and consumption insurance for individuals who approach the courts seeking debt relief and a fresh start (Cohen & Lawless, 2012; White, 2007). To the extent bankruptcy liberally sanctions default and credit risk, “bankruptcy is the ultimate free-market solution to bad debt” (Sullivan, Warren, & Westbrook, 2000, p. 260). Over three decades, the number of consumer bankruptcies in the USA grew seven times faster than the population, from 285,000 filings in 1984 to a peak of over two million in 2005, arriving at 910,000 cases in 2014 (AOUSC, 2014b; U.S. Census Bureau, 2015). The upward trend proceeded with two closely related developments: mounting economic insecurity for households (Hacker, 2012) and rising consumer debt payments as a percent of income (Federal Reserve Board, 2014). The consumer bankruptcy filing rate in 2014 was 59 % below its peak in 2005 when the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) went into effect (AOUSC, 2014b;

U.S. Census Bureau, 2015). As of 2013, an estimated 4.1 % of U.S. families had declared bankruptcy in the previous 5 years (Bricker et al., 2014). That year, the courts addressed the fate of \$172 billion in outstanding debts, mostly mortgages, carried by households with only \$110 billion in assets (AOUSC, 2014a).

A simple answer to the question of what causes consumer bankruptcy is debt. In 2013, 43 % of U.S. households held home mortgages, 38 % owed credit card debt, 31 % had vehicle loan payments, and 20 % carried education loans (Bricker et al., 2014). The average household spent 10 % of its earnings to service debt (Federal Reserve Board, 2014), well below the ratio for households approaching bankruptcy. A strong correlation exists between consumer debt and bankruptcy filings (Dawsey, Hynes, & Ausubel, 2013). Tabb (2007) explored the relationship between U.S. filing rates and ten measures of consumer credit for a nationwide sample; statistically significant relationships existed for all measures except credit card delinquencies. Although bankruptcy and debt are highly correlated, correlation alone does not establish causation. Yet the strong link between debt burdens and bankruptcy rates suggests more punitive bankruptcy measures that do not address underlying debt and default issues are unlikely to reduce the filing rate (Athreya, 2004).

What is the face of the typical filer seeking debt relief in bankruptcy: someone down on his/her luck after getting sick and losing a job, using credit cards to pay medical bills and make ends

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meet? Or is it the savvy consumer who abuses credit cards intending to waltz into bankruptcy to wipe out debts and then repeat the profligate cycle? Congress hotly debated these two faces of bankruptcy for 8 years before passing the 2005 bankruptcy reform law. The general public assumes financial mismanagement is the main cause of bankruptcy, while debtors point to economic pressures and unanticipated trigger events, such as job loss and medical problems (Hacker, 2012; Sullivan et al., 2000). Most of the debate and rhetoric accompanying BAPCPA, as well as the academic literature, views bankruptcy from these opposing perspectives.

Filers are a cross-section of society short on options for confronting financial adversity. Most filers come from the middle class, having attended college and owned homes (Warren & Thorne, 2012), but have negative net worth and owe medical debt (Pace, 2013). Although filers represent the full spectrum of human capital, their earnings are lower than non-filers' (Warren & Thorne, 2012). For both Chaps. 7 and 13 debtors, excluding their debts, monthly expenses still exceed income (AOUSC, 2014a).

The purpose of this chapter is to synthesize and evaluate bankruptcy research in the context of current trends in consumer bankruptcy, debtor default, and household finances. The chapter explains the basics of consumer bankruptcy and how Chaps. 7 and 13 differ. Two competing conceptual frameworks address debtor behavior and bankruptcy policy. The aftermath of major bankruptcy reform in 2005 is discussed. The chapter ends with ways to address the bankruptcy problem and recommendations for future research.

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## Consumer Bankruptcy Basics

Bankruptcy allows filers to discharge most unsecured debts. Some unsecured debts, such as child support and alimony, student loans, and most tax debts, cannot be discharged (MacArthur, 2008–2009). Secured creditors can repossess or foreclose on collateral to enforce repayment before or after bankruptcy.

While bankruptcy is governed by federal law, title 11 of the United States Bankruptcy Code (The Code), implementation varies by judicial district. Consumer debtors choose between chapter 7 or 13; the “chapter” refers to sections of the Code. Chapter 7 is the most common debt liquidation option, accounting for 68 % of consumer cases in 2013 (AOUSC, 2014a). While The Code provides for a court trustee to liquidate assets to repay creditors, fully 93 % of Chap. 7 cases are no-asset cases once state-defined exemptions are applied (U.S. Department of Justice, 2014). Within a few months of filing, most unsecured debts are discharged.

In contrast, a Chap. 13 plan commits all of a debtor's disposable income to debt repayment for up to 5 years. Chapter 13 is often used to prevent home foreclosure and vehicle repossession (MacArthur, 2008–2009). Despite the law's promise of a “fresh start,” more than two-thirds of Chap. 13 plans are not completed, in which case debtors do not receive discharge (Evans & Lown, 2008). Failure to make payments is the reason for half of Chap. 13 dismissals (AOUSC, 2014a).

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## Credit Expansion

The finance industry has broadly increased access to credit for many customers via credit cards, payday lending, and subprime mortgages. Debt burdens often become hardships and are associated with higher bankruptcy filing rates, particularly where insufficient assets offset obligations (Tabb, 2007).

Prior to the deregulation of credit card interest rates in 1978, lenders were very selective in issuing cards. Once interest ceilings were lifted, card issuers extended offers to marginal customers (Black & Morgan, 1999). The 1980s saw the “democratization of credit” when almost anyone could get a credit card (Black & Morgan, 1999, p. 1), a market development that has persisted (Han & Li, 2011). Extending credit to risky consumers is highly profitable because they pay elevated interest rates (Black & Morgan, 1999). Looser credit standards result in higher bankruptcy rates, but with sophisticated computer algorithms lenders still make healthy profits.

Two problematic lending practices emerged in full force during subsequent decades. First, the 1990s witnessed explosive growth in the payday lending industry (Montezemolo, 2013). Payday loan and vehicle title lenders provide exorbitantly priced credit that both serves and afflicts bankruptcy filers (Han & Li, 2011). In the 21st Century, regulation by the federal government and many states has served to tame the industry somewhat (Montezemolo, 2013). Second, leading up to the global financial crisis of 2007–2009, U.S. credit markets supported tremendous increases in mortgage debt, as subprime and predatory mortgage lending also flourished (Sermons, 2012). Overall, filers' debt-to-income ratios (total debt balance/annual income) rose from 1.4 in 1981 to 1.7 in 1991 and leapt to 3.4 in 2007, of which more than one-third was unsecured debt (Lawless et al., 2008; Leicht, 2012).

As the world economy struggled to recover from the global financial crisis, consumer borrowing plummeted (Bricker et al., 2014). Access to credit tightened, and many consumers defaulted on credit obligations. Some of the poorest debtors, especially those who were not subject to wage garnishment and had no assets at risk of loss, logically chose "informal default," bypassing the costly formal bankruptcy system and enduring collection actions without court protection (Dawsey et al., 2013). Concurrently, the share of U.S. families reporting any savings fell sharply from 56 % in 2007 to 52 % in 2010, partially recovering by 2013 to 53 % (Bricker, Kennickell, Moore, & Sabelhaus, 2012; Bricker et al., 2014). Two-thirds of American households held at least one credit card in 2013, with just over half carrying a balance (Board of Governors, 2014). Credit, often from predatory lenders, is commonly used by Americans to cope with stagnant incomes and growing expenses (Sermons, 2012).

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### Conceptual Frameworks to Explain Bankruptcy

Growth in bankruptcy filings has been explained by two opposing conceptual frameworks. One theory blames the reduction in stigma for debtor

lapses (economic incentives model), while advocates of a structural (financial distress) explanation blame economic insecurity and a fraying social safety net (Garrett & Wall, 2014).

### Economic Incentives Model

According to the incentives model, the stigma associated with filing has diminished, leaving savvy consumers to take advantage of the bankruptcy system (Dawsey et al., 2013). Shrewd consumers calibrate their behavior to maximize financial gain from bankruptcy relief while retaining their assets (White, 2007). Meanwhile, bankruptcy courts permissively sanction consumers' strategic evasion of responsibility at the expense of creditors with contractual rights to repayment. Much of the literature supporting the economic incentives perspective is based primarily on economic modeling rather than data about debtors themselves. A leading advocate of the economic incentives perspective is law professor Zywicki (2007) who argues that the growth in filings reflects moral decay among borrowers unwilling to fulfill their obligations. Zywicki (2007) identifies three factors that have contributed to this growth: shifts in the costs and benefits of filing that make bankruptcy more attractive, a reduction in personal shame and social stigma, and the impersonalization of the debtor–creditor relationship.

Fay, Hurst, and White (2002) emphasize that households are most likely to enter bankruptcy when it is financially advantageous and in communities where doing so is socially acceptable. In a 10-year time series following over 6900 households, including an oversampling of low-income families, prospective financial benefit from bankruptcy was a leading predictor of whether a household member filed. In sum, "the incentives model argues that a variety of changes in legal, social, and economic institutions during the past 25 years have increased the attractiveness of bankruptcy and reduced the overall costs of filing" (Zywicki, 2007, p. 277).

## Financial Distress Explanation

The structural or financial distress explanation contends that increased economic insecurity, accompanied by aggressive extension of credit, has fueled the growth in bankruptcy. In a challenging environment with fewer societal support systems, hardships such as sickness and changes in family composition tip the balance towards household insolvency, according to findings from the 1979–2008 National Longitudinal Survey of Youth (NLSY) and the 2004 Survey of Consumer Finances (SCF) (Maroto, 2012; McCloud & Dwyer, 2011). Based on two decades of triennial SCF responses, Xiao and Yao (2014) showed that income disruption events push consumers into delinquency, particularly those who are vulnerable based on their lifecycle stage, family configuration, education, assets, and debts. Deregulation of the credit industry has made consumer and mortgage credit too readily available to marginal borrowers (Black & Morgan, 1999). Athreya (2004) argues that stigma is not dead and offers an alternative explanation for rising rates, focusing on how computer technology has lowered transaction costs for lenders who market credit to marginal credit risks. Meanwhile unfair lending practices ensnare more consumers, and aggressive collection practices overwhelm debtors (Han & Li, 2011; Montezemolo, 2013). Studies using nationwide filings and Census data at the county or zip-code level show that collection efforts precipitate bankruptcy filings, particularly in states without anti-harassment statutes and robust garnishment restrictions (Dawsey et al., 2013; Lefgren & McIntyre, 2009).

Health care costs continue to increase faster than inflation; before the Patient Protection and Affordable Care Act of 2010 (Affordable Care Act) went into effect in 2014 many workers were not covered by health insurance (McCloud & Dwyer, 2011). The lack of insurance and rising deductible and coinsurance payments pushed more families with medical events or debts into bankruptcy, according to survey findings from the SCF and an original representative nationwide sample of 2300 respondents (Himmelstein,

Warren, Thorne, & Woolhandler, 2009). After mortgages, medical debt is the most common filer liability and the largest unsecured amount, followed closely by credit cards; fully 90 % of filers in Utah carried medical debt (Pace, 2013). The substantial amount of medical debt was a reliable predictor of repeat filings. Compared to the two years preceding BAPCPA, medical debt increased and credit card debt declined post-reform. The impact of the Affordable Care Act is yet to be determined since it went into effect in 2014.

The primary proponents of the structural explanation are Sullivan et al. (2000) and Sullivan, Warren, and Westbrook (2006), who started collecting data for the Consumer Bankruptcy Project (CBP) in the late 1970s, continuing through 2007 (Warren & Thorne, 2012). The CBP relies on extensive data from bankruptcy files and interviews with debtors in a representative sample of judicial districts to explore the circumstances that drive them to file. The CBP revealed that debtors are middle class Americans who are drowning in debt due to misfortune and poor judgment. The two main factors fueling consumer bankruptcy are the growth in consumer credit and increasing economic insecurity (Warren & Thorne, 2012).

The CBP concluded that bankruptcy laws serve those for whom they were intended but in a less than satisfactory manner. Proposals to make bankruptcy more bureaucratic and punitive to smoke out abusers are not worth the time, money, and collateral damage (Lawless et al., 2008). Bankruptcy is the social safety net of last resort in a country with a beleaguered support system (Sullivan et al., 2000; Hacker, 2012).

Because the bankruptcy files do not specify reasons for filing, CBP researchers interviewed debtors about their circumstances (Sullivan et al., 2000). Many middle class Americans are “economically fragile,” a circumstance much more widespread than indicated by bankruptcy statistics (Sullivan et al., 2000, p. xiv). The CBP identified five sources of financial stress: elevated consumer debt levels, economic volatility, rising medical costs combined with limited insurance coverage, divorce and single-parent child-rearing,

and housing expenses for debtors clinging to unaffordable homes. These causes of distress match many of those identified by participants in credit counseling designed for bankruptcy filers: excessive debt levels, income disruption, unexpected expenses, job loss, personal illness or injury, divorce, child birth or adoption, death of a family member, retirement, and identify theft (Linfield, 2011). Finally, Sermons (2012) attributes high bankruptcy rates to a combination of living costs rising faster than incomes, job losses, health care costs, low savings, and unexpected expenses.

Braucher (2006) examined the interaction between consumer culture and structural economic arguments as explanations of overindebtedness, concluding that neither explanation is adequate by itself to explain the growth in bankruptcy. There is truth in each perspective.

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### **Bankruptcy Abuse Prevention and Consumer Protection Act**

After extensive lobbying by creditors, Congress passed the BAPCPA in 2005. Its key provisions are income limits for Chap. 7 eligibility, discharge prohibitions for several types of debt, homestead exemption restrictions, and new documentation requirements (Cornwell & Xu, 2014; White, 2007). Debtors flooded the bankruptcy courts prior to BAPCPA implementation to avoid the higher costs and restrictions of the law (Truitt, 2007).

BAPCPA shifts more of the cost of credit failure onto borrowers (Mann, 2006). The reforms encourage delayed filings that exacerbate the burdens on debtors and society. Besides devising new deterrents to insolvency, BAPCPA does not remedy underlying problems that lead to overwhelming debts and relentless creditors. Tabb (2007) observed that “debtors file bankruptcy in very predictable numbers, depending not on what the bankruptcy law provides, but on how burdened they are with debt” (p. 104). BAPCPA may have arrested the upward trend in bankruptcy filing rates, but financial crises, debt delinquency, creditor excesses, economic insecurity, and flat wages persist.

### **Abusive Filings**

With regard to preventing abuse, the framers of BAPCPA assumed that the main reason for filing is overspending by irresponsible debtors. However, most debtors report a combination of factors including medical expenses, job loss, wage stagnation, housing costs, business failure, social program cuts, and abusive collection practices (MacArthur, 2008–2009; Sermons, 2012). In 2010 only 16 % of filers earned more than \$50,000 (Linfield, 2011). One-third of 2013 Chap. 13 filers reported having filed during the previous 8 years, some of whom initially failed to secure a discharge (AOUSC, 2014a). A study of repeat filers in Utah found fewer than 10 % of debtors potentially abusing the system (Lown, 2006). Regardless of BAPCPA, judges have always had the legal authority to deny a discharge to abusers. BAPCPA appears not to have curbed opportunistic behavior (White, 2007). Rather it resulted in new incentives and shifting strategies, while imposing significant new costs.

### **Filing Rates**

Filings jumped 30 % in 2005 to over two million cases with a spike in Chap. 7 filings prior to implementation as debtors rushed to file under the old law (AOUSC, 2014b). With so many cases in 2005, it was no surprise that filings fell dramatically in 2006, to just over 600,000. Subsequently, as the Great Recession took its toll, household finances deteriorated significantly (Bricker et al., 2014), and filings rebounded, though falling short of former levels, reaching 1.5 million cases in 2010 (Garrett & Wall, 2014).

As the tepid economic recovery progressed and household debt burdens eased (Federal Reserve Board, 2014), the number of cases declined steadily to 0.9 million in 2014 (AOUSC, 2014b). Annual filing rates were 0.7 % of U.S. households in 2014, down from 1.4 % in 2004, similar to 0.8 % in 1994, and up from 0.3 % in 1984 (AOUSC, 2014b; U.S. Census Bureau 2015). With nearly 10 years’ hindsight, it appears

BAPCPA's chilling effect on consumer bankruptcy filing rates has endured.

While the Great Recession increased financial distress and the demand for bankruptcy, the decrease in filings post-BAPCPA is attributed to several factors. One undisputed fact is that filing for bankruptcy has become more costly due to increased filing and attorney fees, placing bankruptcy relief out of reach of a larger number of desperate debtors (Truitt, 2007). Mandatory pre-filing counseling and pre-discharge financial education add costs but accomplish little (Lawless et al., 2008). Debtors who filed post-BAPCPA had higher debt-to-income ratios compared to pre-reform filers (Lawless et al., 2008). The economic recovery beginning in 2009 brought a substantial decline in household debt burdens, but net worth and savings were likewise markedly depressed (Bricker et al., 2014).

## Chapter Choice

Under BAPCPA's means test, debtors with incomes exceeding their state's median can be required to file a Chap. 13 case with a repayment plan rather than a Chap. 7 with its more complete debt relief (White, 2007). This means test may have resulted in a small reduction in the average incomes of Chap. 7 filers, as intended, although the change was not statistically significant (Lawless et al., 2008). However, this policy may create a disincentive to work as opportunistic debtors try to keep their income below the median level during 6 months before filing in order to qualify for Chap. 7 (White, 2007). Another key BAPCPA provision redirecting filers away from Chap. 7 is a cap on state homestead exemptions that determine how much home equity can be protected from liquidation (Cornwell & Xu, 2014).

The means test and homestead exemption cap had a noticeable impact on chapter choice, based on analysis of a range of state-level variables over 8 years (Cornwell & Xu, 2014). The share of Chap. 13 cases rose from 28 % in 2004 pre-BAPCPA to 34 % in 2014, with considerable volatility in between (AOUSC, 2014b). A dramatic swing from 20 % in 2005 to 42 % in 2006 stands

in contrast with the more measured rise in the share of Chap. 13 cases comparing 5-year averages, 29.2 % during 2000–2004 before BAPCPA and 30.5 % during 2010–2014 (AOUSC, 2014b).

As noted, Chap. 13 generally offers less debt forgiveness than Chap. 7, particularly since completion rates are much lower in Chap. 13 (AOUSC, 2014a). While proponents of the incentives model of bankruptcy wanted to use BAPCPA to direct more debtors into repayments plans, high Chap. 13 filing rates result in repeat filings and thus more bankruptcies (Lown, 2006). Further, few debtors earn above their states' median income, especially since many filings are prompted by job loss or reduced income (Warren & Thorne, 2012).

## Other Considerations

While the credit card industry spent millions lobbying for BAPCPA, it is unlikely to result in higher payments to credit card issuers (Leicht, 2012). For one thing, BAPCPA gives any portion of auto and other secured loans that exceed collateral value higher priority in repayment than unsecured debts. More importantly, policies to increase collections face the reality that debtors possess limited repayment capacity: the vast majority of Chap. 7 filings are no-asset cases with no repayment to creditors (U.S. Department of Justice, 2014), and only one-third of Chap. 13 debtors complete their repayment plans (AOUSC, 2014b). Even as the share of Chap. 13 cases rose under BAPCPA, the actual number of Chap. 13 cases declined, consistent with the suppressed filing rate under either chapter and reflecting a decreased role of bankruptcy courts in assisting with debt collection. Most collections for delinquent debts occur outside of bankruptcy courts, documented by a growing volume of consumer complaints to the FTC about debt collection practices (Dawsey et al., 2013).

Several BAPCPA provisions tend to affect low-income filers and their dependents more acutely than others: additional documentation requirements, increased filing fees, automatic stay workarounds for banks that jeopardize debtors' residences, Chap. 13 nondischargeability for

private student loans, and decreased “cramdown” protections for secured debt in excess of collateral value (MacArthur, 2008–2009).

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## Vulnerable Households

A growing body of research promotes accurate information regarding bankruptcy filers. Most filers come from the middle class, whose members are more likely to declare bankruptcy than those in the top and bottom quartiles (Himmelstein et al., 2009; McCloud & Dwyer, 2011). Starting college but not finishing places a person at greater risk for debt delinquency and bankruptcy (Porter, 2012; Xiao & Yao, 2014). In 2010, 58 % of filers had at least some college, up from 54 % in 2006 (Linfield, 2011). Self-employed workers approach the courts when insolvency attends entrepreneurship. While U.S. job growth is tied to small business attempts, they account for approximately 14 % of Chaps. 7 and 13 cases characterized by above-average unsecured debt balances, according to a national random sample for a 2007 survey (Lawless, 2012). Women file alone at a higher rate than men, which reflects the precarious economic status of single women (Lawless, 2012).

Age and race differentials enter the picture as well. Debt delinquency and filing rates are higher in areas with above-average percentages of African Americans, even when analyses account for differences in income, education, credit access, judicial practices, and other plausible explanatory variables (Lefgren & McIntyre, 2009; Xiao & Yao, 2014). With similar research controls, blacks are more likely than whites to file a Chap. 13 repayment plan instead of a Chap. 7 liquidation and thus are less likely to receive a debt discharge (Cohen & Lawless, 2012). From 2006 to 2010 consumer bankruptcy filings increased for debtors ages 18–44 but decreased for debtors age 55 and above, whose ranks swelled from 22 % of the sample in 2006 to 27 % in 2010 (Linfield, 2011). The trend is associated with rising costs for health care and other needs, while incomes remain relatively stationary (Sermons, 2012).

From 2004 to 2012 outstanding student debt tripled from \$364 billion to \$966 billion, averaging 14 % annual growth, with two-thirds owed by borrowers under age 30, results based on a 5 % sample of U.S. households that had credit reports (Brown, Haughwout, Lee, Scally, & van der Klaaw, 2014). In 2010, student debt surpassed credit card debt to become the largest category of non-mortgage household debt (Brown et al., 2014). The student loan delinquency rate has increased steadily since 2004; “nearly one third of the borrowers in repayment are delinquent on student debt, a fact that is masked by the large numbers of borrowers who are in either deferment or grace periods” (Brown et al., 2014, p. 18). Although student loans are not dischargeable in bankruptcy, their nonnegotiable presence contributes to default on types of loans that bankruptcy courts do address.

While we would like to think that the risk of personal bankruptcy is limited to certain “vulnerable” groups, Leicht (2012) provides evidence that virtually all middle and lower income Americans are but one job loss or medical event away from bankruptcy. Decades of wage stagnation and rising income instability, accompanied by abundant credit and predatory lending, mean that consumers face the rising costs of housing, health care, child care, and higher education with the temptation to borrow beyond their ability to repay (Hacker, 2012; Leicht, 2012).

Hacker (2012) describes the “Great Risk Shift” that imperils middle class families as they face higher housing, health care, and education costs, along with more responsibility for retirement security, while struggling with stagnant incomes and a volatile economy. Due in part to a frayed social safety net, the American middle class has a far higher risk of personal bankruptcy than counterparts in other industrialized nations (McGregor, Klingander, & Lown, 2001).

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## Life After Bankruptcy

The Bankruptcy Code states that the purpose of bankruptcy is to provide debtors with a “fresh start.” Yet, after discharging their unsecured debts,

most filers are barely making ends meet, burdened with nondischargeable debts and residual effects of the personal financial issues that led to bankruptcy (Porter, 2012). A significant reduction in earnings is observed up to a decade after filing bankruptcy (Maroto, 2012).

A bankruptcy filing stays on a credit report for up to 10 years. Creditors treat previous filers differently for secured and unsecured loans, offering nondischargeable vehicle loans more readily than dischargeable credit card debt. Based on empirical modeling using both the SCF and the Panel Study of Income Dynamics (PSID), Fisher and Lyons (2010) conclude that having filed for bankruptcy substantially “increases the probability of being denied access to a loan. The flag also increases interest rates for unsecured loans and lowers the credit limits available to households” (p. 3175).

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### Addressing the Bankruptcy Problem

Bankruptcy law fails to address the underlying issues of abundant credit, weak usury laws, financial insecurity, high medical costs, and creditor incentives to lend to high-risk, high-profit borrowers. Over the past three decades U.S. policies have contributed to growing income and wealth disparities and a fraying social safety net (Bivens, Shierholz, Mishel, & Gould, 2012). Making bankruptcy more costly has only increased the total burden borne by debtors and society. Mann (2006) advocates integrating bankruptcy policy with the broader system of resources and alternatives society offers individuals with financial challenges. For example, the removal of debtor-friendly bankruptcy provisions should be accompanied by demands on creditors and offset by concessions to consumers in areas such as lending transparency, insurance affordability, usury laws, and tax policy.

Consumer bankruptcy can be addressed in terms of credit demand and credit supply. First, the literature emphasizes individual choices and public policies that would reduce the need for borrowing (credit demand) that is unsustainable

for consumers: increase household savings and minimize debt dependence for regular living expenses (Bricker et al., 2014; Lawless et al., 2008); obtain adequate health insurance, perhaps through public health care improvements like the Affordable Care Act (Himmelstein et al., 2009); strengthen unemployment insurance (Garrett & Wall, 2014); improve public transit to alleviate the financial pressures of personal vehicle ownership; and adequately fund education and occupational training programs to improve household earning potential (Brown et al., 2014; Porter, 2012).

Consumer bankruptcy losses to creditors and consumers can be addressed by improving the supply of credit. Recommended actions promote alternatives to payday loans and other high-cost emergency credit (Braucher, 2006; Han & Li, 2011); revisit usury laws (Montezemolo, 2013); impose a lender tax on defaulted debt as does Belgium (Mann, 2006); strengthen creditor harassment statutes (Dawsey et al., 2013); bolster underwriting standards to ensure borrowers have the capacity to repay, along the lines of the consumer protection provisions of Dodd-Frank in 2010 (Leicht, 2012); and, following up on the Credit Card Act of 2009, limit credit card fees and restrict onerous and deceptive terms of credit (Montezemolo, 2013). Protections from financial reforms should be tailored to avoid unnecessary reductions in credit offerings that facilitate entrepreneurship, human capital development, income maintenance during emergencies, etc.

Regulation of creditors may be advisable to protect consumers. With credit scoring models and credit reports, lenders control their rates of default (Mann, 2006). Lenders can turn off credit to borrowers at any time, as they did in 2009–2010. Mann (2006) provides evidence that credit card charge-offs rose steadily prior to the global financial crisis, but rather than cut back on lending, creditors opened the credit floodgates. Obviously borrowers are not the only parties with control over “social losses [from] financial distress” (p. 425).

Legal reform could provide a more consistent bankruptcy experience across regions by reducing judges’ procedural discretion and standardizing

state statutes for asset exemptions and garnishment laws (Levitin, 2006). Professional associations, such as the Uniform Law Commission, research and recommend legislation to encourage states to adopt similar statutes. Alternatively, federal lawmakers can issue mandates that apply in all states, such as BAPCPA's homestead exemption cap (Cornwell & Xu, 2014). State and judicial inconsistency produces extremes, ranging from weak incentives for debtor responsibility to punitive legal cultures protecting creditors. For the interested reader, multiple sources offer detailed comparative bankruptcy information by state (e.g., Lefgren & McIntyre, 2009, pp. 376–377; *Nolo Press*, n.d.).

Citing low financial literacy levels, Braucher (2006) argued for a comprehensive K-12 financial education program to reduce bankruptcy. The program could be modeled after homebuyer education programs and campaigns to change attitudes and behaviors related to antismoking, racial tolerance, and safe sex. Just over half of CBP respondents (55 %) indicated that consumer education might have helped them avoid bankruptcy, while the remainder believed education would not have helped (Thorne & Porter, 2007). Effective interventions must be adapted to distinct populations by age, race, sex, and education level. Post-secondary programs would reach young adults as they become increasingly independent. Possible settings for instruction include colleges, associated with student loans or the regular course curriculum; banks, required for certain borrowing transactions; and places of employment, both civilian and military.

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## Research Needs

There is much we do not know about the pathways to bankruptcy and how the need to file can be averted. The most valuable studies to date employ data from public court records and detailed surveys of consumers in and out of bankruptcy. The Public Access to Court Electronic Records system has vastly improved access to court data. Still, large time investments are required to comb through non-tabular documents

for items of interest. Court records lack basic demographic information—such as age, race, and gender—but contain a wealth of information covering recent addresses, household characteristics, employment, earnings, assets, debts, previous bankruptcies, collection proceedings, and other topics. CBP funding, provided by the National Science Foundation and other sources, made possible phone interviews and a written survey filled out by debtors, besides extensive review of corresponding court data in several districts. Researchers creating their own datasets can collect current data for the variables and geography they select. Such studies need generous time allowances, arrangements for data entry assistance, and an adequate sample size.

Data sources that include individuals both in and out of bankruptcy may be sparse on bankruptcy details but often are nationally representative with large sample sizes and many demographic and other variables to which bankruptcy outcomes can be tied. Longitudinal surveys, such as PSID and NLSY, further our understanding of the root causes and aftermath of bankruptcy (Fay et al., 2002; Maroto, 2012). Key cross-sectional data sources include the SCF, credit reporting bureaus, and major lenders. Researchers can compare debtors who filed for bankruptcy and those in similar trouble who managed to avoid filing. What choices or opportunities were theirs? Which group of debtors is better off a few years later?

An obvious need for research is on the role of medical expenses as a precursor to bankruptcy now that the Affordable Care Act has been implemented. Multiple studies (Himmelstein et al., 2009; Pace, 2013) clearly implicate medical expenses as a bankruptcy trigger. The roles of low cognitive function, mental illness, and addictions in bankruptcy have yet to be documented. Is there a link between health problems and repeat filings? More broadly, what gaps in the social safety net are most critical to encumbered consumers or most easily addressed? What role can employers play in helping workers avoid bankruptcy?

As bankruptcy law continues to evolve, policy makers and legal practitioners would benefit from updated evidence regarding the incentives to begin and complete bankruptcy under

BAPCPA, unravelling outcomes associated with various components of the law. For example, one could evaluate the assertion that mandatory credit counseling has had little deterrence effect on filers (Lawless et al., 2008). If financial pressures and unexpected trigger events are the main causes of bankruptcy, can debtor education improve completion rates or help prevent repeat filings? Most debtor counseling and education is offered online; what is the optimal timing and format to engender financial literacy that might avert future distress from debt?

Connections between state laws, judicial practices, and Chap. 13 outcomes are not well understood. For instance, how hastily debtors are dismissed from Chap. 13 for failure to make monthly trustee payments varies among districts. Also, more research is needed on the bearing of local and national macroeconomic conditions on bankruptcy behavior (Garrett & Wall, 2014). Various categories of debtors identified in the section titled “Vulnerable Households” merit focused study. Among others, these include self-employed workers, women, student loan holders, those with medical expenses, and people of different races and backgrounds. While racial differences in filing rates and chapter choice have been documented, the reasons behind the statistics remain unknown. Bankruptcy is supposed to provide a “fresh start,” but most debtors are still in financial trouble after discharge (Maroto, 2012). Fisher and Lyons (2010) suggest the need for research on the length of time bankruptcy should remain on a credit report, as the flag that assists with creditor decisions results in significant costs and barriers for individuals.

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## Summary

Consumer bankruptcy is very much a middle class phenomenon. The volatile economy, reduced job security, and stagnant wages accompanied by rising housing, education, childcare, and medical expenses weigh on the middle class and all Americans. Financial setbacks for a growing number of debtors result from pursuing higher education, homeownership, and entrepreneurship.

Borrowing to attend college (but failing to graduate), buying a house, and starting a business are risky ventures. Declining real wages and shrinking employee benefits, aggravated by irresponsible lending, contribute to middle class debt burdens that too often end in bankruptcy.

Household finances deteriorated significantly as a result of the 2008 global financial crisis. Financial distress sent many individuals looking for relief to bankruptcy courts, which had become less debtor-friendly under restrictive reforms implemented in 2005. Furthermore, federal bankruptcy law is applied inconsistently across districts, channeling debtors in some areas (and selected races) into Chap. 13 plans that are costly and often inconclusive. Households often circumvent the legal system and slip into informal bankruptcy. The underlying causes of bankruptcy, including economic realities and alternatives to default, are keys to understanding the behavior of individuals in bankruptcy. Informed public policies and individual choices can reduce losses from insolvency and consumer bankruptcy.

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