A STUDY OF THE CAUSES OF CONSUMER BANKRUPTCY

William R. Bartmann, Executive Director

BACKGROUND

The goal of the study was to test the "conventional wisdom" widely assumed to be true by the popular press and mass communications channels, especially the Internet. The experience of the principal led to a suspicion that significant errors existed in those popular assumptions and beliefs regarding the causes of consumer bankruptcy.[1] The thesis driving the need for the study was a belief that most consumer bankruptcy filings were the result of fatigue from a constant bombardment of debt collection activities, especially litigation, by debt buyers.[2]

Conventional wisdom said that consumer bankruptcies were driven by debt loads that were unmanageable.

The message communicated by the mass media was that credible research had been done and that the research tended to support the conclusion that bankruptcy, while unfortunate, was largely unavoidable. After all, if a consumer is so far "upside down" as to never "dig out from under" then bankruptcy was the only alternative; distasteful though it may be.

A review of the popular press and internet sites repeatedly hammered home the conclusion that bankruptcy was driven by unexpected medical expenses. For example, an article posted to *Investopedia* claimed:

> *"A study done at Harvard University indicates that medical expenses are the biggest cause of bankruptcy, representing 62% of all personal bankruptcies. One of the*

[1] It is important to note that while there are credible research papers available, that research did not seem to be the driver of the conventional wisdom for the causes of bankruptcy. Correspondingly, independent academic research efforts were not the focus of this study.

[2] A debt buyer is a company that purchases charged-off debts, mostly credit cards, from major banks. The debt buyer, which may be a public company or privately held, purchases those debts at an extreme discount and then attempts to recover the investment from the consumer. According to the Office of the Comptroller of the Currency, 82% of such debt sales are made by 5 major banks and are purchased by fewer than 20 debt buyers. Over the past 10 years, debt buyers have become continually more aggressive in their use of litigation as a collection tool. According to their annual reports, several debt buyers rely on litigation for more than 50% of their annual income. During 2013, debt buyers will file between 10 million and 15 million lawsuits against consumers for debt collection.

> *interesting caveats of this study shows that 78% of filers had some form of health insurance, thus bucking the myth that medical bills affect only the uninsured."*

Many similar websites hosted by other mass media outlets[3] tended to arrive at similar conclusions. Interestingly, websites hosted by bankruptcy attorneys also hammered home this same theme. While such websites are clearly soliciting business, the fact remains that the average consumer cannot really discriminate fact from fiction, especially when exposed to a given version of the truth repetitively.

Correspondingly, it is easy to understand why consumers would adopt such a scenario and point of view. After all, if a consumer is so far "upside down" as to never "dig out from under" then bankruptcy is the logical course of action for a consumer.

THE CENTER FOR CONSUMER RECOVERY STUDY

In 2013, the Center for Consumer Recovery, a 501(c)3 corporation, undertook a study of the causes of consumer bankruptcy. Participants in the survey were drawn from a nationally representative sample of 3,082 bankruptcy petitioners who had filed bankruptcy in 2013. The methodology used to conduct the survey were a personal interview with the consumer, a review of the consumer's credit report, and, where available, a review of the consumer's bankruptcy petition.

Once collected, the data from the individual participants was analyzed to determine, where possible, causes and effects.

FINDINGS AND CONCLUSIONS

1. Litigation increases the incidence of bankruptcy filings.

    An overwhelming majority of individuals who filed for bankruptcy said the number one reason for filing bankruptcy was not the amount of debt, nor the volume of collection calls. Instead, the vast majority (78%) cited the commencement of debt collection litigation as the number one reason they filed bankruptcy.

    Respondents remarked that once they were sued they felt helpless and hopeless and at the mercy of an unforgiving court system where the odds were stacked against them.

    This data conclusively demonstrates that debt collection litigation being filed is the number one factor given as the primary reason for the decision to file bankruptcy.

    - 78% of consumers reported debt collection litigation as the primary reason for filing bankruptcy.

[3] Some examples are *CNN. USAToday, Yahoo Finance, Business Week* and the *New York Times*.

- 74% of consumers reported that they were pursued by a debt buyer.
- 72% of consumers listed credit card debt as their primary unsecured indebtedness.
- 57% of consumers reported all three conditions:
    - Largest indebtedness was credit card
    - Pursued by debt buyer
    - Debt collection litigation had been filed.

This data is supported by research at the Texas A&M University's Private Enterprise Research Center that stated, "…most bankruptcies (84%) are caused by adverse events instead of strategic timing."[4]

Conclusion: In 2012 there were 1.4 million bankruptcy filings. If 57% of the 1.4 million who filed bankruptcy last year were caused by the filing of litigation by debt buyers, the abatement of all debt buyer suits would potentially reduce this number by 800,000.

Additionally, Senator Elizabeth Warren and John Silvia, Chief Economist of Wells Fargo both have opined that a ban on debt buyer collection litigation would result in a reduction in the bankruptcy rate by 50%.

2. The abatement of debt buyer litigation would likely reduce the national unemployment rate by about one full point.

Litigation impedes hiring. Otherwise qualified candidates are denied employment based on litigation/judgments on their credit report.

The Bureau of Labor Statistics reports that the number of unemployed persons is currently 11.5 million (7.4%).

In 2010, 13.1 million civil actions were filed in state courts for the collection of debt.[5] Of that total, upwards of 10.7 million are filed by debt buyers.[6]

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[4] *Personal Bankruptcy: Why Do People File?,* PERCspectives on Research, Private Enterprise Research Center, Li Gan, Tarun Sabarwal and Shuoxumn Zhang, Texas A&M University, February 2012.

[5] *Examining the Work of State Courts: An Analysis of 2010 State Court Caseloads*, Court Statistics Project, December 2012.

[6] The number of suits filed by debt buyers is based upon percentages of debt buyer litigation reported in two studies: *Debt Weight: The Consumer Credit Crisis in New York City and Its Impact on the Working Poor,* The Urban Justice Center, October 2007, reports that 89.3% of the debt collection cases were initiated by debt buyers. *Justice Disserved: A Preliminary Analysis of the Exceptionally Low Appearance rate by Defendants in Lawsuits Filed in the Civil Court of the City of New York*, MFY Legal Services Consumer Rights Project, June 2008, publishes results that, when analyzed, report 73.7% of debt collection cases are initiated by debt buyers. Taking the average of these two studies, one can predict that 81.5% of all debt collection litigation is initiated by debt buyers or the law firms that represent them.

The Society of Human Resources Managers survey reported 64% of hiring managers would not hire an otherwise qualified candidate if he/she had a lawsuit/judgment on their credit report.[7]

If only 25% of the 10.7 million individuals sued by debt buyers were deemed to be "otherwise qualified" (2.67 million) and 64% of them were not discriminated against, a total of 1.7 million would be offered jobs. To reduce the unemployment rate by 1 full point only requires the employment of 1.5 million individuals.

Conclusion: If there is an abatement of debt buyer lawsuits, millions of Americans will not be discriminated against in the job market and otherwise qualified candidates will gain employment for which they are currently being denied.

3. The abatement of debt buyer litigation would create $35 billion in principal reduction/debt forgiveness for millions of families.

Non-litigation debt is settled at an average of 30 cents on the dollar, while litigated debt is settled in excess of 100 cents on the dollar (after interest, court costs and attorney fees).

According to the Nilson Report, $51 billion in charged-off credit card debt was sold by major US banks to debt buyers last year.

This debt was purchased at an average of 10 cents on the dollar or $5 billion.

The zero-litigation debt collection model is premised on a recovery rate of 3X the price paid for inventory. If $5 billion was paid to purchase the debt, expected collections would equal $15 billion, creating a $36 billion principal reduction/ debt forgiveness for the consumer.

The litigation model is premised on a 100% return of amount owed ($51 billion) plus interest, plus court cost, plus attorney fees. Each judgment entered against the consumer is at the full inflated amount and stays on the consumer's credit report until satisfied.

Conclusion: If all $51 billion of charged-off credit card debt was collected by a non-litigation methodology it would produce a principal reduction/debt forgiveness of $36 billion annually.

[7] *Background Checking: The Implications of Credit Background Checks on Hiring Decisions*, Society of Human Resource Managers, August 24, 2010.

4. An abatement of debt buyer litigation would reduce the backlog in the American court system.

Millions of defective law suits are filed each year that unnecessarily clog up the court system. As a result, justice is denied to worthy disputes.

In 2010, the most recent year for which data is available, 18.2 million civil actions were filed in state courts.[8] Recent testimony before the House Judiciary Subcommittee on Constitution and Civil Justice estimates that 72% of all civil cases on state and local court dockets are debt collection cases.[9] Studies in Virginia have indicated that 70% to 80% of all filings are debt collection cases.[10] Studies in Dallas County, Texas, reported that 75.3% of civil actions related to debt collection.[11]

The conclusion is that in 2010, about 13.1 million civil actions were filed in state courts for the collection of debt. Of that total, upwards of 10.7 million are filed by debt buyers.[12] This estimate correlates well to the private estimate of industry experts.[13]

In 2013, at least 10 million lawsuits will be filed by debt buyers to collect credit card debt – some think that the number of lawsuits will be closer to 20 million.[14]

Conclusion: Abatement of robo-signed debt collection litigation would remove millions of defective cases from an otherwise already clogged court system.

5. An abatement of debt buyer litigation would protect 30 million American families.

Robo-signed debt collection litigation destroys the financial condition of millions of American families. The damage can last as long as 10 years and change the entire economic dynamic of affected families for generations.

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[8] Ibid. 5

[9] *Testimony before the House Judiciary Subcommittee on the Constitution and Civil Justice,* Joanne Doroshow, Executive Director, Center for Justice & Democracy, New York Law School, March 12, 2013.

[10] *Debts, Defaults and Details: Exploring the Impact of Debt Collection Litigation on Consumers and Courts*, Virginia Law & Business Review, Mary Spector, Associate Professor of Law and Co-Director SMU Civil Clinic, Southern Methodist University Dedman School of Law, Fall 2011, "Furthermore, 97.22% of the cases where an affidavit was filed, the affidavit constituted the only evidence of the validity of the account. Only 14 (2.8%) files contained affidavits made by an agent or employee of the original creditor."

[11] *Debts, Defaults and Details: Exploring the Impact of Debt Collection Litigation on Consumers and Courts*, Virginia Law & Business Review, Mary Spector, Associate Professor of Law and Co-Director SMU Civil Clinic, Southern Methodist University Dedman School of Law, Fall 2011

[12] Ibid. 6

[13] According to Peter Holland: "This is a $100 billion-a-year industry. It's created a crisis in our small-claims courts. There's tens of thousands of cases filed without proof just in Maryland. Nationwide, it's in the tens of millions." *A Push for More Proof in Debt-Collection Lawsuits*, The Baltimore Sun, Jamie Smith Hopkins, July 24, 2011.

[14] Internal estimate based on reported volumes of lawsuits filed by publically held debt buyers; and consistent with the estimates by Peter Holland, who runs a University of Maryland law school clinic. Ibid. 10.

The 26 largest debt buyers currently hold in their portfolios an estimated 104 million consumer accounts[15]. The Federal Reserve Bank estimates that about 35 million Americans are being pursued by a debt collection agency.[16] Since most consumers have multiple accounts in default at the same time, these numbers correlate well and represent an average of 3 accounts per consumer in default.

Correspondingly, the potential for litigation for any one consumer at a given time exceeds 100%. The number of accounts the consumer has in default when spread across multiple debt buyers who are litigation oriented can easily result in multiple lawsuits simultaneously.

90% are not supported by documentation.[17] The mere filing of a petition by a debt buyer requires the consumer to expend money to defend as well as take time from work for which most are uncompensated.

COST OF CREDIT

160 points off of FICO score	Judgments stay on record for 10 years or longer
$30,000 automobile	Additional $5,400 over 48 months
$200,000 home	Additional $50,000 over 30 years
Insurance	Higher premiums or denial of coverage
Employment	Increased likelihood (64%) of not getting a job for which the applicant is otherwise qualified
Rental	Denial of opportunity or increased deposit

15 The estimate is derived from sales volumes reported by The Nilson Report, 2002 to 2012 and the 2011 Annual Reports of Encore Capital Group, Portfolio Recovery Associates, and Asset Acceptance Capital Corp. and assuming the balance of the debt buying industry generally reflects the major players.

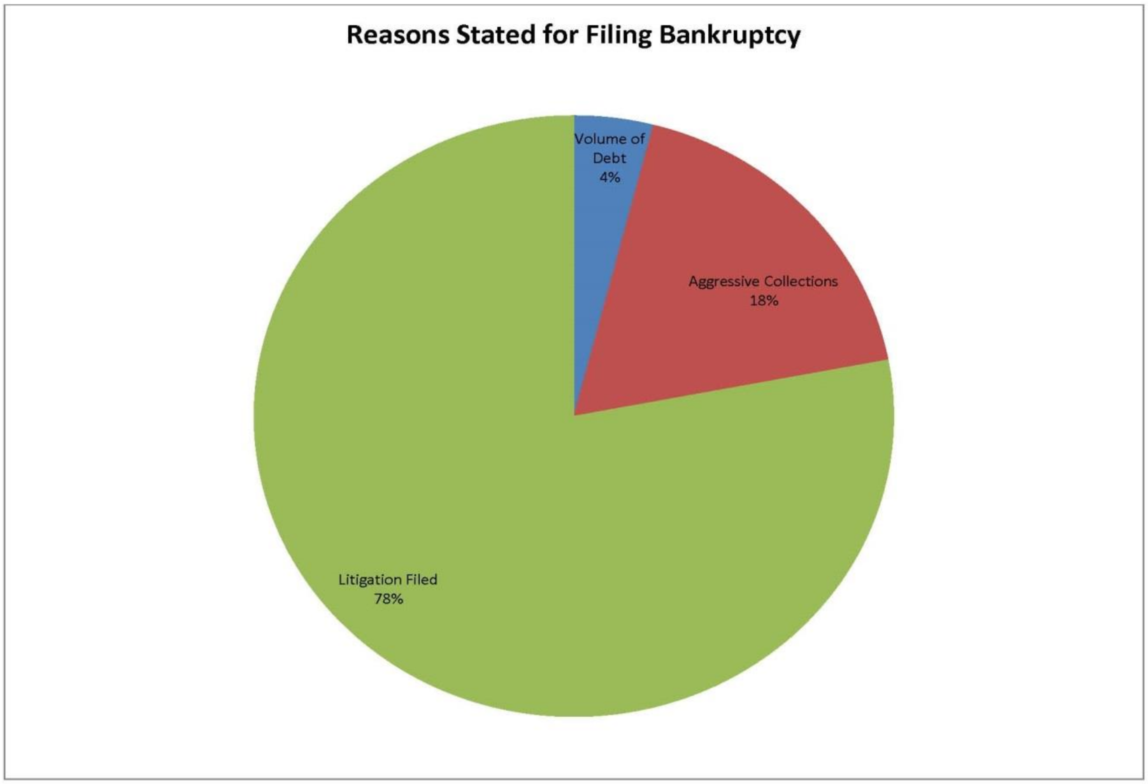
16 *Household Debt and Credit Report, Fourth Quarter 2012*, Federal Reserve Bank of New York, February 2013

17 Judge Noach Dear, a civil court judge in Brooklyn, who said he presides over as many as 100 debt collection cases a day said, “I would say that roughly 90% of the credit card lawsuits are flawed and can’t prove the person owes the debt.” *Problems Riddle Moves to Collect Credit Card Debt*, Jessica Silver-Greenberg, The New York Times, August 12, 2012. An extremely high percentage of lawsuits filed by debt buyers provide no proof other than an affidavit signed by an employee of the debt buyer. Three different studies of debt buyer litigation report rates of 99.0% (*Debt Weight: The Consumer Credit Crisis in New York City and Its Impact on the Working Poor*, The Urban Justice Center**,** October 2007, “Our study reveals that in 99.0% of applicable cases reviewed, debt buyers submitted facially invalid evidence in support of applications for default judgments”) , 94.5% (*Where’s The Proof? When Debt Buyers are Asked to Substantiate Their Claims in Collection Lawsuits Again NYC Employees and Retirees, The Don’t,* District Council 37 Municipal Employees Legal Services, December 2009, “Debt buyers were unable to substantiate their claims in 94.5% of cases reviewed”) and 97.22% (*Debts, Defaults and Details: Exploring the Impact of Debt Collection Litigation on Consumers and Courts*, Virginia Law & Business Review, Mary Spector, Associate Professor of Law and Co-Director SMU Civil Clinic, Southern Methodist University Dedman School of Law, Fall 2011, “Furthermore, 97.22% of the cases where an affidavit was filed, the affidavit constituted the only evidence of the validity of the account. Only 14 (2.8%) files contained affidavits made by an agent or employee of the original creditor.) of cases where debt buyers were unable to substantiate their claim.

Credit card	Only eligible for higher interest rate card
Banking	May become ineligible for conventional banking and be forced to use shadow banking.

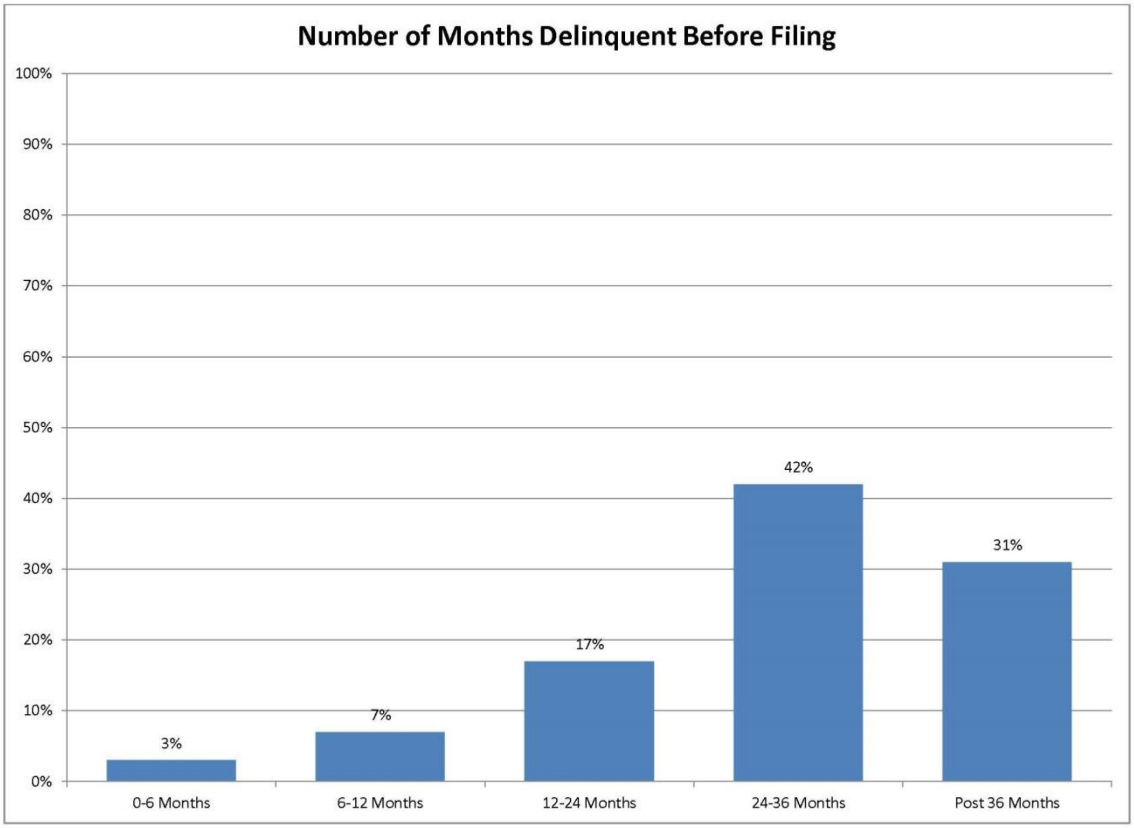
Conclusion: An abatement of debt collection litigation would prevent 30 million American families from being sued with defective petitions. It would also spare them from disproportionate punishment that creates an unnecessary hardship on the family for year and years.

APPENDIX 1 – Reasons Stated for Filing Bankruptcy

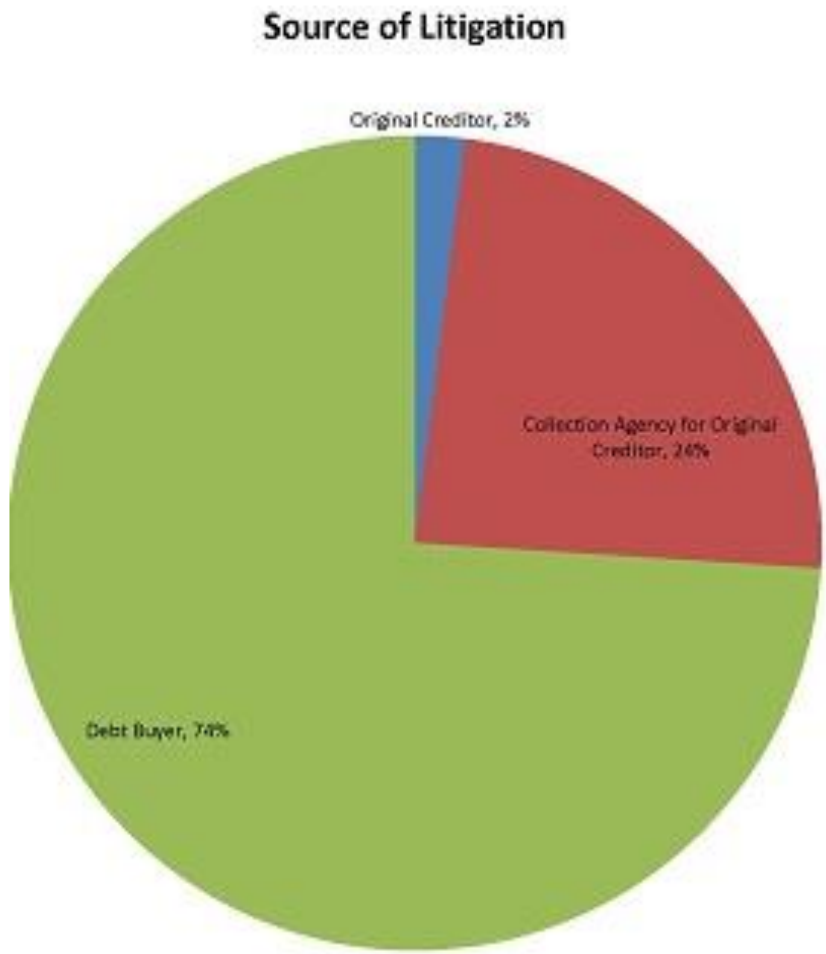


Survey based on interviews with petitioners, review of credit bureau reports and bankruptcy documents for 3,082 bankruptcy filings in 2012.

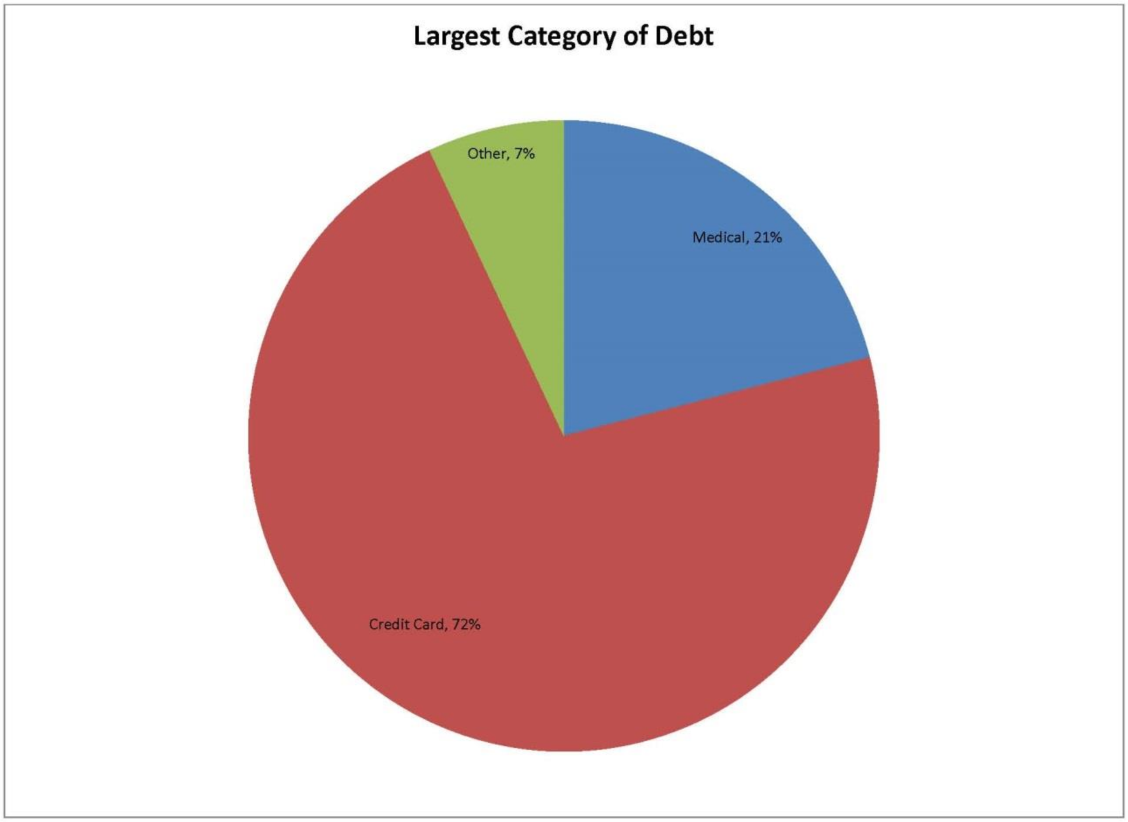
APPENDIX 2 – Number of Months Debt Delinquent Before Filing



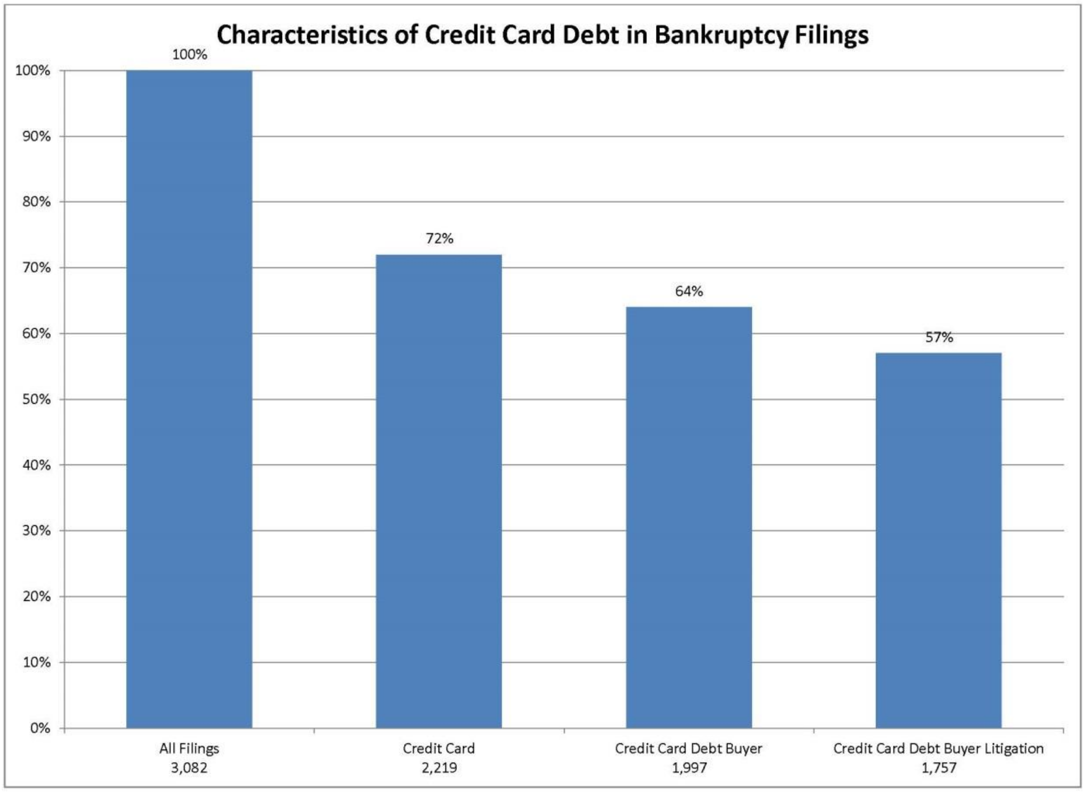
APPENDIX 3 – Source of Litigation



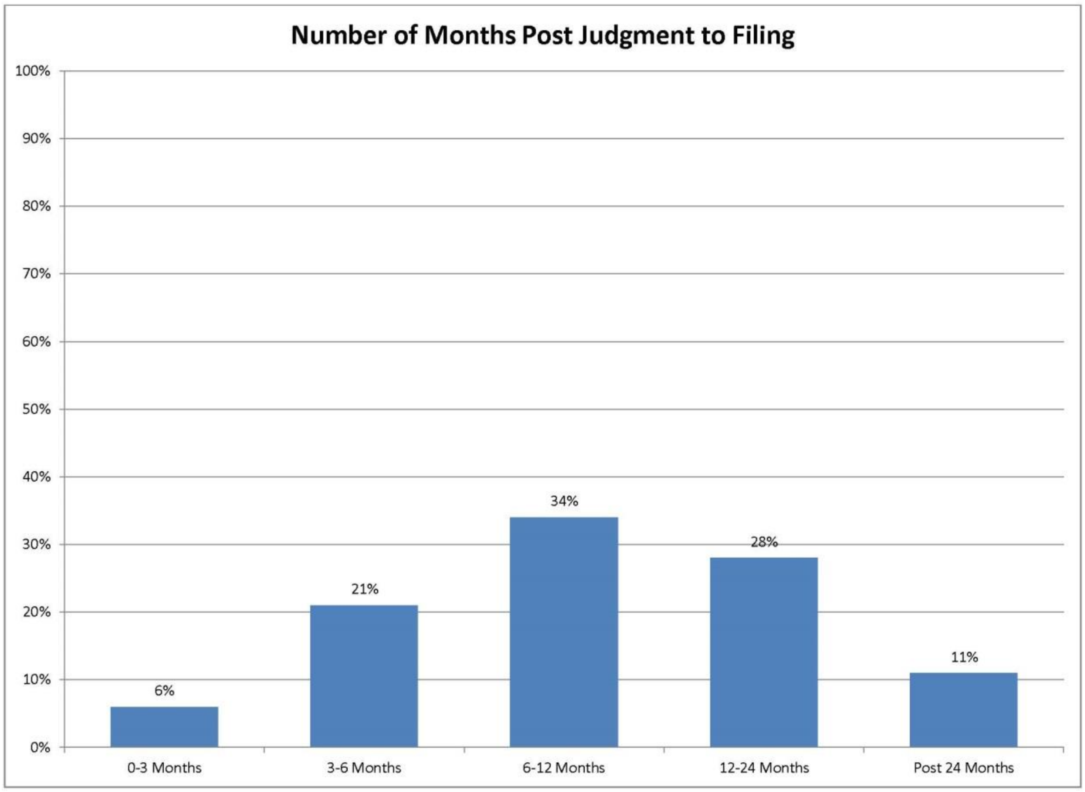
APPENDIX 4 – Largest Category of Debt



APPENDIX 5 – Characteristics of Credit Card Debt in Bankruptcy Filings



APPENDIX 6 – Number of Months Post Judgment to Filing



APPENDIX 7 – SURVEY RESULTS

2013 BANKRUPTCY SURVEY

Survey Objective	To assess the degree to which consumer bankruptcy filings correlate with credit card debt buyers and the litigation strategies of those debt buyers.
Methodology	Data was gathered from 3,082 interviews of petitioners who filed bankruptcy in 2013, a review of the consumer's credit report, and a review of the bankruptcy petition. (Not all information was available for each survey).
Consumer Privacy	While each consumer consented to the interview and the bankruptcy petition is a public record; disclosure of personal information is governed by The Fair Debt Collection Practices Act, The Fair Credit Reporting Act and the Gramm-Leach-Bliley Act. Surveys are assigned a unique code so that there can be no correlation back to the specific consumer and no breach of privacy.

SURVEY RESULTS:

Geographic Region Residence	[18%] Northeast [37%] South [21%] Midwest [24%] West
Age of Head of Household	[16%] Less than 30 [43%] 30 to 50 [32%] 50 to 65 [9%] 65 and older
Gender of Head of Household	[52%] Male [41%] Female [7%] Not Available
Race Head of Household	[73%] White [15%] Black [8%] Hispanic [4%] Other
Education of Head of Household	[13%] less than HS [30%] high school [19%] some college [9%] Associate Degree [18%] Bachelor Degree [7%] Master degree
Marital Status	[13%] Never Married [54%] Married [2%] Separated [11%] Widowed [20%] Divorced
Number Children at Home	[58%] None [16%] One [17%] Two [9%] Three or more
Employment Status (HH = head of household)	[82%] HH Employed [18%] HH Unemployed [84%] Spouse Employed [16%] Spouse Unemployed
If Unemployed, number months?	[22%] Less than 5 weeks [25%] 5 to 14 weeks [16%] 15 to 26 weeks [37%] more than 26 weeks
Largest Category of Debt	[72%] Credit Card [21%] Medical [7%] Other
Type of Creditor Causing Stress	[74%] Debt Buyer [24%] Collection Agency for Debt Buyer [2%] Original Creditor
Reason for Filing Bankruptcy	[3%] Volume of Debt Unmanageable [19%] Collection Activity [78%] Litigation Filed
Number Months Delinquent Before Filing	[3%] less than 6 months [7%] 6-12 months [17%] 12-24 months [47%] 24-36 months [31%] more than 36 months
Number Months Post Judgment Before Filing	[6%] less than 3 months [21%] 3-6 months [34%] 6-12 months [28%] 12-24 months [11%] more than 24 months