Bankruptcy Reform

Bankruptcy reform legislation has more lives than a zombie in a Stephen King thriller. Bankruptcy reform has passed both houses of Congress on three occasions since 1998, only to be vetoed, or die on the vine due to political squabbling. Ironically, the common feature among these bills is that experts from all corners do not believe the proposed legislation will work.

Bankruptcy reform seeks to reverse the soaring bankruptcy rate, prevent more consumers from going broke, generate a higher dividend for creditors and decrease the likelihood an individual will file another bankruptcy. To that end, the proposed legislation creates a means-test to determine whether an individual has the financial resources to repay a portion of his debt. However, a study by the American Bankruptcy Institute found that only 3 percent of consumer filers would be required to continue making payments to their creditors.

Commentators argue that the proposed legislation, drafted at the pleasure of the monolithic credit card industry, fails to address the factors that have created the bankruptcy boom. In the rush to force more consumers to take responsibility for their debts, Congress focused exclusively on the debtor. Meaningful bankruptcy reform must focus on both the debtors and the lending industry. Legislators ought to examine the lending industry and make changes that will force lenders to get smarter about the risks they take. Effective legislation will need to include changed usury laws, consumer education and heightened disclosure requirements.

To illustrate the point, take a look out your window as you drive home from work. You will likely see more Payday Loan stores than fast food restaurants. These predatory lenders litter America's strip malls and urban neighborhoods. They offer cash in a pinch at interest rates over 500 per cent. If families have to pay 10 times the market rate for a loan, they are certainly in no shape to afford the loan in the first place. To stem the tide of insolvency, regulations need to cap the amount of interest predatory lenders can charge. In 1980, approximately 300,000 consumers filed bankruptcy. In 2003, 1.6 million consumers filed. The lending industry was deregulated in the late 1970's and a crush of consumer debt ensued. There seems to be no mistaking the correlation between the deregulated lending industry and the meteoric rise in bankruptcy filings.

Consumer groups have pushed for legislation to compel lenders to disclose the costs of carrying consumer debt. Consumer advocacy groups have lobbied for laws that would require credit card companies to disclose to customers how long it will take to pay off a balance if only minimum payments are made, and how much interest the borrower is likely to pay. In the last bankruptcy bill, lenders watered down this provision so that it required them only to tell borrowers how long it would take to pay off a generic $500 debt.

In addition to changed usury laws, a comprehensive solution to the glut of bankruptcy filings ought to take into account the rising costs of health care. Medical bills are a factor in one-third of consumer bankruptcies, and medical bills are a direct cause of 10 per cent of the filings. Conversely, medical bills are a negligible factor in countries with universal health insurance. In Canada, for example, the consumer bankruptcy rate per capita is less than one-third that of the U.S. However, the problem goes beyond the uninsured. As more employers shift the burden of insurance costs to their workers, many families are finding themselves unable to meet higher co-payments and out-of-pocket deductibles. Nothing short of universal insurance would end this problem, although almost any effort to extend coverage to the 43 million uninsured Americans would have some effect in curbing the bankruptcy rate.

The Draconian "solution" that has wound its way through the halls of Congress since 1998 is a heavy-handed attempt by the lending industry to have its cake, and eat it too. The solution to the problems that ail the American consumer, and the consumer credit industry, lies in a careful examination of both consumer's borrowing and spending habits and creditor lending practices.

Source: "The Fragile Middle-Class: Americans in Debt" by Teresa A. Sullivan , Elizabeth Warren and Jay Lawrence