# Why going broke is a fact of life in America

## Bankruptcy has become little more than a few months in purgatory, rather than the seven-year ache -- and lifelong disgrace -- it once was

By Liz Pulliam Weston

*"Capitalism without bankruptcy is like Christianity without hell."* -- Frank Borman, former CEO of bankrupt Eastern Airlines, in 1986

Bankruptcy, once regarded as a shameful and humiliating failure, has become an everyday fact of life: More Americans filed for bankruptcy last year in the United States than in the entire decade of the 1960s.

And with millions of consumers struggling under record-breaking debt loads in an environment of rapidly rising interest rates, those numbers are likely to continue climbing in the months and years ahead.

What's behind the bankruptcy boom? In simplest terms, it stems from a growing tendency for consumers to spend more than they can afford to repay. But there are other, less obvious factors at work, including the shrinking availability of health insurance and the rise of computerized credit scoring.

Ask a lender and you'll hear about a variety of causes, from irresponsibility on the part of consumers to increased advertising by bankruptcy attorneys. And, inevitably, lenders lamenting soaring default rates point to a lessening of the stigma surrounding bankruptcy as a key reason for its increase. Bankruptcy today is little more than a few months in purgatory, rather than the seven-year hell -- and lifelong disgrace -- it once was.

## E-Z credit leads to easy filing

In reality, lenders themselves have helped diminish the pain of bankruptcy by drastically reducing the financial penalties associated with it. In the battle to increase market share, credit card issuers and other lenders have extended more and more credit to shakier and shakier borrowers. This rush to extend loans, both before and after bankruptcy, has left many Americans awash in debt while simultaneously making it financially much easier to recover if they walk away from their obligations. Consider: (emphasis added by Legal Helpers...)

- As the volume of credit card lending nearly quadrupled between 1990 and 2003, from $173 billion to $683 billion, subprime credit card lending -- aimed at people with troubled credit -- grew even faster, increasing by as much as 45% annually throughout the 1990s.
- Getting credit after a Chapter 7 liquidation filing, once a trial, is now easy for many bankrupts. Mortgage loans are available as little as six months after bankruptcy, while many debtors report getting new credit cards before their case is even completed.
- The spread of credit scoring has helped erase the stigma of bankruptcy, since score formulas weigh recent behavior more heavily than past behavior. Someone who handles credit responsibly after a bankruptcy, credit experts say, often can boost a credit score far more quickly than those who continue to struggle with debt.

Far from being stigmatized, bankruptcy is often considered the smartest option for people struggling with mountains of debt. That isn't just the opinion of attorneys who encourage debtors to file. It's a view shared by lenders, mortgage brokers and even collection agencies.

## Bankruptcy changes lives

Peter Duffey, a professional debt collector in Kansas, makes his living trying to get people to pay what they owe. But every day he deals with people who are drowning in medical bills or credit card debt with no realistic hope of ever paying it off. Bankruptcy is often less of a financial, emotional and social strain, he says, than dealing with collection agency calls, wage garnishment and the threat of lawsuits.

"While I don't agree with using bankruptcy to avoid your responsibilities," Duffey said, "I do have to say that at times I encourage debtors to file to ease the strain their situation is creating on their life."

The advantages of bankruptcy are typically so profound that people who struggle to repay their debts, rather than having them erased, are often seen as foolish for continuing to throw good money after bad debts.

"Unfortunately, it's not what we were taught by our parents," said Don Scott, a Los Angeles mortgage broker with 13 years' experience. "But the smart ones are the ones who spend time in the penalty box and get on with their lives."

## On paper, filing can make sense

Chance Nelson, 32, learned how the system worked shortly after he graduated from business school with $32,000 in credit card debt. Nelson went to work for a mortgage company in Indianapolis and discovered that people with recent bankruptcies could get loans -- while those who hadn't erased their debts often could not.

People with big debt loads often see their credit scores suffer and frequently make matters worse by falling behind on their payments as they juggle various bills. Lenders eventually become reluctant to extend more credit and may raise interest rates on existing debt, making repayment all the more difficult.

Those who wipe out the debt, by contrast, can begin rebuilding their credit histories almost immediately. While the bankruptcy can remain on a credit bureau report for up to 10 years, its effect on a borrower's credit score -- the three-digit number lenders use to gauge creditworthiness -- diminishes over time, particularly if the consumer establishes new credit and pays bills on time.

Nelson said that within months of his Chapter 7 filing, he was able to get several credit cards and an auto loan -- with a 21% interest rate -- on a used Dodge Dakota. Five years later, he owns a home, two rental properties, a motorcycle and a new car, all bought with loans with interest rates of 6% or less. Nelson said his FICO credit scores are in the high 600s and low 700s, just below the cutoffs most lenders use for people with excellent credit.

"You have to bite the bullet at first and take a high-interest loan," Nelson said. "But today I can get a loan for anything I want."

## Some can't get past the stigma

That reality infuriates Tania Brown, a Lima, Ohio, woman who has been paying off substantial medical bills for several years -- and who knows her credit will take years more to recover once the final payment is made. Brown said she has yet to renege on a debt, yet has less access to credit than people who have.

"I have a friend who filed bankruptcy and only one year later she was able to obtain a credit card, a car loan and store charge cards," Brown said. "Really, the only thing keeping many people from filing is their own sense of pride and honesty."

Still, the rising tide of filings means Americans are far more likely to know someone, and perhaps several someones, who have declared bankruptcy in recent years. As bankruptcy expert Elizabeth Warren of Harvard University points out, more Americans will file for bankruptcy this year than for divorce, and more Americans will officially go broke than will have a heart attack, graduate from college or be diagnosed with cancer.

That increasing familiarity with bankruptcy means the word is spreading that filing Chapter 7 or Chapter 13 isn't the end of your financial life.

## Others see bankruptcy as a tool

Alana of Indianapolis filed for bankruptcy six years ago after the birth of a critically ill child and a subsequent divorce left her with substantial medical and legal bills. Both her sisters have since filed, after their husbands lost their jobs. So did Alana's current husband, who lost his job shortly after a divorce left him with $50,000 in debt.

Most of her friends have also declared bankruptcy, she said. What's more, everyone -- Alana, her husband, her sisters and her friends -- was 25 or under when they filed.

"We aren't deadbeats," insisted Alana, who asked that her last name not be used to protect the privacy of her friends and family. "We are all basically in the same boat . . . unprepared for life's bumps and bruises."

Since her bankruptcy, Alana has bought two houses and a car, which she recently refinanced from the dealer's 13% rate to 7% with her credit union.

## The gold mine in dicey credit

It wasn't always so simple to bounce back from financial failure. The phenomenon of easy credit for bankrupts can be traced to the late 1970s, when the Supreme Court all but did away with usury laws by ruling that lenders needed to pay attention only to interest rates caps imposed by the states where they were headquartered -- not the states where their borrowers lived. Lenders responded by moving operations to states with high or nonexistent interest rate caps.

The lack of limits on interest rates meant lenders could charge riskier borrowers more. Pioneers in this so-called "subprime" or "nonprime" market often reaped huge profits, enticing more and more lenders to follow their lead.

By the 1990s, the subprime gold rush was on. Subprime home loans comprised less than 5% of the mortgage market at the start of the decade and more than 20% by its end. Credit card issuers such as Providian, Metris and Capital One made subprime lending a specialty.

## Credit offers follow quickly

The market is certainly substantial. By 2003, nearly 30 million American households either had no credit score -- because they don't use credit -- or had a credit score below 660, the usual cutoff for "prime" borrowers. That's according to CardWeb.com, one of the leading trackers of credit card trends.

Obviously, though, it's also a market fraught with risk. By 2001, many subprime credit card issuers watched their profits evaporate and defaults mount as the economy faltered. By 2003, losses soared to 19% in the subprime market, compared with about 7% in the general credit card market. Regulators shut down some subprime issuers and issued new guidelines that significantly restricted lending at most others.

Despite the crackdown, people who file for bankruptcy still report receiving credit card offers. Those who don't can apply for secured cards, which give borrowers a credit limit equal to the deposit they make with the issuer bank. Within 12 to 18 months, many of these secured cards automatically convert to regular, unsecured cards if borrowers have paid on time.

Getting mortgage loans isn't much more difficult. High-rate subprime loans are available less than a year after a bankruptcy filing, mortgage brokers say, while people two years out of bankruptcy can qualify for government-subsided Federal Housing Administration loans with rates only slightly higher (1/2 percentage point or so) than conventional loans.

## 'It feels good to be free!'

That's not to say bankruptcy comes without a cost. Financially, the higher interest rates bankrupts pay take a toll; Lorraine T. Kasmala of San Antonio figured the car she purchased after bankruptcy cost her twice the initial purchase price.

Finding places to live and jobs can be a trial, as well. Many bankrupts get turned down for apartments and jobs because of their filings, and pay more for car insurance, since many insurers use credit history as a factor in setting rates.

Then there's the stigma, which some debtors say they still feel despite their awareness that they're far from alone. Anna Inman of Memphis, who filed to erase $30,000 in medical and credit card bills, found the process "simple and relatively easy . . . though it was fairly humiliating on a personal level."

Still, many -- like Heather O'Konski of Clayton, Mo. -- feel they're better off financially and emotionally from having declared bankruptcy.

"The constant stress of having all of those bills hanging over my head is gone," said O'Konski, who eliminated $30,000 in medical bills and other debt. "The experience has made me much more responsible with money. . . . It feels good to be free!"