FinRegLab

Debt Resolution Options

Market & Policy Context

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About FinRegLab

FinRegLab is a nonprofit, nonpartisan innovation center that tests new technologies and data to inform public policy and drive the financial sector toward a responsible and inclusive financial marketplace. With our research insights, we facilitate discourse across the financial ecosystem to inform public policy and market practices.

About the National Foundation for Credit Counseling

Dedicated to educating Americans about how to reduce personal or household debt responsibly, the National Foundation for Credit Counseling (NFCC) is a trusted, nationwide resource for education and support in building financial management skills. Through its network of nonprofit agencies and certified counselors, the NFCC offers impactful approaches to debt reduction and improved credit standing, whether consumers are struggling with credit card debt, decisions about housing, or student loans. For more information about the NFCC or to be connected to a certified counselor, please call 800-388-2227 or visit www.nfcc.org.

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This report is part of a broader research project to evaluate data, technology, and other innovations' potential to help consumers recover more quickly from personal and economic crises such as COVID-19. The independent empirical research described in the report is being conducted in collaboration with Professor Stephanie Moulton of The Ohio State University and Marsha Courchane and Adam Gailey of Charles River Associates, using data from member agencies of the National Foundation for Credit Counseling and other sources. This report lays a foundation for future subsequent empirical and policy analyses.

Many of the insights in this report were derived from interviews with stakeholders in the financial services, technology, and civil society sectors. FinRegLab would like to thank stakeholders who participated in interviews and discussions, including members of our project Advisory Board and Counseling Agencies Council. We would also like to thank individuals who provided valuable feedback on this report. They include:

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1. EXECUTIVE SUMMARY

Even prior to the COVID-19 pandemic, one in three U.S. adults were estimated to have experienced at least one severe loan delinquency over their lifetimes, and one in eight to have filed for bankruptcy.[1] The downstream effects of financial distress can continue for years, in part because credit reports are used to help determine eligibility for employment, rental housing, and insurance, in addition to future loans. Households' ability to rebound from past periods of distress affects not only their own future financial health, but the nation's longstanding racial wealth gaps and recovery from broader economic downturns.

Yet while mortgage and student loan workouts have been a major research and policy focus in the past decade, options for families struggling with credit card and other general unsecured credit have not received much public attention. Current debt resolution structures are often fragmented and prone to break where consumers experience a second financial hardship due to layoffs, medical emergencies, or divorce. Lenders' repayment options and practices vary, and different types of intermediaries offer consumers very different debt-resolution strategies. The complex ecosystem can be overwhelming for consumers to navigate, particularly when they are also struggling to resolve underlying shocks.

As rising inflation and interest rates increase pressure on household budgets, the need for effective, efficient resolution options for unsecured credit is becoming more urgent. Stakeholders are debating the potential for new workout plan structures and data and technology innovations to facilitate better outcomes at scale. FinRegLab is working with researchers from The Ohio State University and Charles River Associates to empirically evaluate potential innovations using data from pilot programs organized by the National Foundation for Credit Counseling and other sources. The results could be important not only to nonprofit counseling agencies, but to a broad range of other market participants, advocates, and policymakers.

This report lays the project's foundation by surveying the market landscape, available research, and policy issues and challenges as stakeholders work to develop a more effective suite of tools for helping consumers recover from personal and broader economic crises such as COVID-19. Key findings include:

1.1 Loan delinquencies and other evidence of past financial distress can have significant downstream effects on households' economic activities. Vulnerability to shocks appears to be increasing, and households of color are particularly likely to experience financial hardships.

In part because loan delinquencies and other negative credit history remain on consumers' credit reports for seven to ten years, past periods of financial distress can affect households' stability and wealth-building activities long after they have rebalanced their budgets. Negative credit history affects both loan approvals and pricing, making it harder for households to invest in reliable transportation, homeownership, and small business formation. Credit reports are also used by many prospective employers and landlords and by some types of insurers. Research also shows linkages between financial distress and physical and mental health, cognitive performance, marital relationships, and work productivity, which can prolong financial hardships or trigger additional ones.

U.S. households' vulnerability to financial shocks appears to be increasing. For example, income volatility has increased substantially over the past several decades, with up to a third of adults reporting occasional to frequent variations in monthly income on the eve of the pandemic.[2] About 16 percent of consumers surveyed by the Federal Reserve in 2021 reported experiencing hardships in the past year in connection with natural disasters.[3] Medical events also continue to be a major driver of financial distress despite health care reform.[4]

At the same time, lower savings rates and higher debt levels also make it harder for households to weather financial hardships when they occur. Even a decade after the 2008 financial crisis, surveys found that only about half of consumers had specifically set aside emergency savings or "rainy day" funds. Nearly 40 percent of respondents reported that they could not cover more than one month of expenses in the event of a loss of their primary income, even if they exhausted their savings, sold assets, turned to friends and family, and borrowed money.[5] While savings rates improved in response to stimulus programs during the pandemic, those balances are now eroding in the face of inflation and higher interest rates.

The likelihood of experiencing periods of financial distress is especially high for households of color, given that historical discrimination in lending, employment, education, housing, and other sectors have helped to create substantial disparities in median incomes, liquid assets, and other financial metrics. On the eve of the pandemic, median Black and Hispanic households had less than 75 percent of the income and 25 percent of the liquid assets of median White households.[6] Racial disparities in delinquencies, collections items, and bankruptcies contribute to substantial disparities in credit scores and make it more difficult to close longstanding racial wealth gaps through homeownership and small business formation.[7]

1.2 Current options for resolving unsecured loans are fragmented and complicated for consumers to evaluate. Structures that spread payments out over longer time periods can be more affordable yet may increase the risk that consumers experience a second financial hardship before they can resolve their debts.

Borrowers who are struggling to repay credit card or other unsecured loans have historically had five primary alternatives to seek relief: (1) applying for a debt consolidation loan from a new lender; (2) asking for assistance from their current lenders; (3) working with a nonprofit credit counseling agency to set up a multi-lender debt management plan; (4) enrolling with a for-profit debt settlement company that will seek less-than-full-balance (LTFB) settlements from their lenders; or (5) filing for bankruptcy to resolve nearly all of their debts.

However, not all of these options are available to all consumers, and each has potential tradeoffs as to the timing and amount of direct costs, effects on credit reports and scores, and other considerations. For example:

- **Debt consolidation loans** can help some consumers lower their monthly payments and simplify their finances by replacing multiple previous higher-cost loans. But consolidation loans become more expensive and difficult to obtain as consumers' finances deteriorate, and research suggests that the loans can worsen distress levels if they increase long-term debt burdens or consumers incur more debt after consolidation.
- **Lenders' workout options** vary significantly as to whether and what level of concessions are available to borrowers facing financial hardships. Banks typically provide multiple options, but their programs are usually structured in very particular ways in light of regulatory guidance on impaired debts. For example, if delinquent credit card borrowers cannot afford to repay all loan principal within 60 months or to complete a settlement for less than the full balance owed in three months, banks frequently do not offer other settlement options until the loan has been "charged off" for accounting purposes at 180 days delinquency. In the meantime, borrowers' financial situations may worsen and they may begin looking for other debt resolution options.
- **Debt management plans** (DMPs), which are generally administered by nonprofit credit counseling agencies, are structured to repay full balances to multiple lenders over no more than 60 months. Research suggests DMP participants improve their debt loads and increase their credit scores more quickly than consumers with similar credit profiles who do not receive credit counseling or participate in the plans. However, interviews and studies suggest that roughly 50 percent of counseled consumers cannot meet eligibility requirements and that roughly 50 percent of eligible consumers choose not to enroll. The length and cost of payments and the fact that DMP participants are generally required to close their accounts and avoid taking on more debt may make the plans less appealing to consumers.
- **Debt settlement companies** (DSCs) are for-profit intermediaries that seek less-than-full-balance settlements from individual lenders on behalf of consumers who meet their income and other eligibility requirements. Data from large DSCs indicate that about 60 percent of their customers settle the majority of their debts within 36 months; although the settlements average about 50 cents on the dollar, the companies generally charge fees that equal 15 to 25 percent of settled debts. In addition, consumers often incur additional arrearages and credit score damage early in the process, and about 25 percent of DSC customers do not settle any accounts. Lenders vary as to whether they are willing to work directly with debt settlement companies, and may file collections lawsuits if customer communications are cut off after they enroll with DSCs.
- **Bankruptcy options** can give consumers substantial relief across multiple types of debt, but have significant effects on the price and availability of credit and other financial health metrics going forward. Consumers who meet the income limitations for Chapter 7 filings are typically discharged from their debts within six months, although they are required to surrender any substantial assets as part of the process. Consumers who file under Chapter 13 are required to pay their disposable income toward their debts for three to five years to obtain discharge, but may be able to retain their homes and cars. Research indicates that as many of two-thirds of Chapter 13 filers do not actually obtain discharge, however, and may be subject to additional interest and penalties when they drop out of the programs. Studies have also found that disproportionate numbers of Black consumers file for Chapter 13 and that Black filers experience worse outcomes than other groups under both Chapter 7 and Chapter 13.

Across these varied options, data and research are limited and methodological issues complicate comparisons between consumers who choose particular alternatives and those who leave past debts unresolved. However, academic studies and interviews underscore a substantial tension between lengthening various workout options to make payments more affordable and increasing the likelihood that consumers experience a second financial shock before they can finish recovery. Absent standardized protocols for dealing with additional hardships, consumers tend to drop out of their initial programs and may be left even worse off than before.

1.3 Consumers often rely on intermediaries to help them navigate this complex system, but frictions between market actors can complicate resolution processes. The activities of for-profit debt settlement companies are particularly controversial.

The fact that most households have multiple credit cards and other sources of unsecured credit substantially complicates workout structures and processes for borrowers and lenders alike. In contrast to mortgage loans, which may constitute a third or more of households' monthly expenses, it may be difficult for any single unsecured lender acting alone to enable consumers to stabilize their broader finances. This creates a collective action problem where lenders could potentially achieve better results if they cooperate, yet also have strong incentives to maximize individual recoveries relative to their peers. It also increases burdens on distressed borrowers, who often must seek to resolve multiple debts while also dealing with job searches, medical emergencies, or other underlying hardships.

Intermediaries can thus potentially benefit both consumers and lenders, and it is not surprising that many consumers turn to them. But in practice, coordination challenges and competitive dynamics can further complicate resolution processes. For example, while most lenders will participate in debt management plans administered by nonprofit agencies, they differ as to whether and when they refer consumers for counseling and how much they contribute toward administrative expenses. Some lenders will not join individual DMPs unless all of a consumer's other lenders participate due to concerns that their concessions would otherwise subsidize competitors' recoveries.

Lenders diverge even more widely in their interactions with debt settlement companies, with some seeking to be first in line for settlement negotiations and others refusing to work directly with them and in some cases filing collections suits against some consumers who enroll with DSCs. A recent survey of large credit card issuers suggests that roughly 50 percent of less-than-full-balance settlements may now occur through such companies,[8] which marks an important milestone given debates about industry practices. While proponents argue that DSCs fill gaps in debt resolution options, critics argue they can substantially exacerbate consumers' financial distress depending on the size of their fees, credit score impacts, and particular business practices.

The complex dynamics between market actors make it more challenging to implement the kinds of workout reforms for unsecured credit that have been adopted for mortgages and student loans in recent years. Based on lessons learned since the 2008 financial crisis, mortgage servicers have adopted standardized waterfalls of concessions and streamlined processes to encourage borrowers to enroll in workout plans before they build up substantial arrearages. As the source of more than 90 percent of student loans, the federal government has also directed implementation of broad-based pandemic forbearances, income-based repayment plans, and debt forgiveness initiatives. In the unsecured context, however, competitive considerations and communications challenges among diverse actors further complicate the provision of early, comprehensive relief for borrowers facing significant hardships.

1.4 Innovations in workout plan structures and data and technology applications have the potential to improve outcomes at scale, but many stakeholders are reluctant to make substantial changes and investments in the absence of additional research.

As rising inflation and interest rates are pushing credit card balances to near-record levels and average rates to 30-year highs,[9] many debt resolution providers are bracing for a potential increase in demand. At the same time, many stakeholders hope that there may also be opportunities to validate new approaches and to build greater momentum around market and policy initiatives in light of continuing economic stressors, increased awareness of racial equity issues, and a deeper appreciation of the importance of increasing the resiliency of both financial systems and households. Rather than assuming that conditions and practices revert to 2019 patterns, they question whether there are ways to build on the experiences of the pandemic to strengthen households' financial stability and to improve options for those consumers who experience future shocks.

Interviews with stakeholders reveal widespread interest in the potential for new repayment plans and data and technology innovations to improve outcomes at scale. Proponents point to the way that digital platforms, new data sources, and predictive algorithms are being used in loan originations, and argue that these same tools could be used to provide more tailored workout options to better meet the needs of distressed borrowers. Some stakeholders see such innovations as part of a broader effort to center the system more closely on consumer outcomes by structuring processes and resolution options to promote long-term household financial stability and customer relationships.

Some improvements in data and technology have already occurred, although adoption has been uneven. For example, many lenders have substantially improved their customer-facing platforms over the past decade and can use them to communicate with distressed borrowers. Several fintech startups have entered the space, in some cases by providing services directly to consumers and in others by providing more sophisticated platforms to lenders and intermediaries. However, lenders often do not prioritize technology investments to improve back-office systems that can play a vital role in administering workout plans, and nonprofit counseling agencies face resource constraints compared to for-profit actors.

Using automated feeds of bank account data could potentially facilitate faster and more sophisticated analyses, but broader market practices and regulatory protections for such data transfers are still evolving. Accessing such information may also be more challenging than in the context of loan originations. Although an increasing number of consumers are willing to share bank account information with lenders at origination when it may help them get better terms, trust between borrowers and lenders may have eroded in situations where loans are severely delinquent. Nonprofit credit counseling agencies collect detailed information from consumers to provide budget advice, but emphasize that processes must be carefully structured to build consumer trust.

Finally, developing new workout structures can also take significant time and effort, for instance by requiring market actors to reprogram existing systems, make changes to their accounting and credit reporting processes, and coordinate with regulators particularly where existing standards do not provide flexibility. New workout structures can also present potential tradeoffs for both lenders and consumers if they affect the timing and amount of losses recorded by lenders or impact consumers' credit scores (and thus future cost of credit) in different ways. In the absence of publicly available research and assurances from regulators about adopting new approaches, many stakeholders are reluctant to make substantial investments in changing repayment plans and processes.

* * *

The forthcoming research project will inform many of these issues by evaluating potential innovations in workout structures and data and technology applications. The empirical analyses will focus primarily on data from counseling agency pilots that have been facilitated by the National Foundation for Credit Counseling over the past several years. Initial topics include:

» **The tradeoffs between length of repayment plans and the amount of recovery,** including pilots of alternative workout structures for consumers who do not qualify for or want to participate in traditional 60-month debt management plans.

» **Short-term programs to help consumers who experience income and expense shocks,** including pandemic relief initiatives and a pilot to help DMP participants who experience a second hardship restabilize their finances without dropping out of the plans.

» **The outcomes of multi-lender debt resolution plans as compared to workouts with individual lenders,** particularly for consumers who have many unsecured accounts.

» **The use of digital platforms to facilitate consumer intake and communications,** including questions about user experience and automated access to bank account data.

» **Use of cash-flow data and more sophisticated predictive algorithms** to help assess what workout options may be most likely to succeed for particular borrowers.

In addition to the empirical research, other reports will explore the potential evolution of related policy, regulation, and market practices based on stakeholder engagement and policy and legal analyses. The goal is to take a broad-based look at potential innovations to support more rapid and inclusive recoveries from personal and broader economic crises such as COVID-19.

* * *

Section 2 of this report provides a primer on the challenges faced by borrowers who are struggling to repay unsecured credit, describing the triggers, cycles, and consequences of financial distress as well as current options for debt resolution and research about those options' scale and outcomes. Section 3 and Section 4 describe how evolution in markets and regulations have shaped this ecosystem, with the first focusing on the two decades leading up to the COVID-19 pandemic and the latter on how the past two years have affected both consumers and debt resolution providers. Section 5 discusses policy issues and challenges as stakeholders seek to improve debt resolution options going forward, and Section 6 concludes with a description of the broader research project.

Appendix A provides an overview of credit counseling, secured credit cards and credit builder loans, and credit repair organizations, which consumers may rely on for generalized advice and assistance in rebuilding their credit after past financial distress. Appendix B and Appendix C summarize debates about front-end policy initiatives that could potentially reduce the number of households struggling with unsecured credit and about modification of credit reporting practices that could potentially reduce the downstream effects of past financial shocks. The Glossary defines common terms and acronyms.

2. PRIMER: DISTRESSED BORROWERS AND DEBT RESOLUTION OPTIONS

2.1 Overview of Unsecured Credit Use and Patterns of Distress

A large majority of U.S. households have some form of general unsecured credit (See Box 1), with credit cards being the nation's largest consumer lending market as measured by the number of users. In 2021, roughly 80 percent of U.S. adults—approximately 200 million consumers—were estimated to hold at least one credit card.[10] About 10 percent of consumers hold other general unsecured personal loans,[11] and roughly a third are estimated to have tried Buy Now, Pay Later (BNPL) products.[12]

These credit products are popular in part because they can help bridge short-term gaps in income and expenditures as well as to finance purchases of durable goods. Yet they also can begin to undermine households' financial stability where unsecured debt has built up due to prior shocks or chronic shortfalls. Roughly two-thirds of active credit card accounts carry revolving balances, and about half of those revolvers make minimum or near-minimum payments in most months.[13] Because minimum payments are often as low as one percent of balances plus interest and fees, consumers who routinely make minimum payments are likely to increase their balances over time,[14] incurring annual percentage rates that can exceed 25 percent depending on credit scores.[15] As a result, revolving credit card balances account for roughly 15 percent of all non-mortgage consumer debt, but the largest share of non-mortgage interest and fees paid.[16]

For borrowers who are becoming overwhelmed, signs of increasing distress may include delinquent payments, penalty fees and rates, and accounts in collection. Distress levels generally worsen during recessions and natural disasters, but are also driven by longer-term market trends and personal events such as illness, death, or divorce. Even prior to the COVID-19 pandemic—and nearly a decade into the longest economic expansion in U.S. history—a 2019 Consumer Financial Protection Bureau survey found that 33 percent of respondents had experienced a significant loss of income and that nearly 40 percent of respondents had struggled to pay bills in the previous year.[17]

This section summarizes how delinquent unsecured loans are typically handled by creditors and collectors; the incidence of income and expense shocks; the long-term consequences of financial distress on households, communities, and the nation's economy; and why these issues impact racial wealth gaps. It focuses primarily on conditions prior to the COVID-19 pandemic, which is addressed in more detail in Section 4. Section 2.2 provides an overview of the major options available to consumers in resolving general unsecured loans.

BOX 1 RELATION OF GENERAL UNSECURED CREDIT TO OTHER DEBT TYPES

This report focuses primarily on general unsecured credit, including credit cards, personal loans, and Buy Now, Pay Later products (See Appendix B). Some of the issues and debt resolution options discussed—such as the effects of administrative complexity, the potential use of data and technology to improve analytics and communications, and bankruptcy options—cross over between loan markets. But the resolution processes and options for student, auto, and mortgage loans also differ in important ways from general unsecured credit:

- **Student lending ($1.59 trillion in balances as of Q2 2022)** differs in part because more than 90 percent of the market is made up of loans held by the federal government.[18] Such loans are difficult to discharge in bankruptcy and have no time limit on collections.[19] However, the federal government can also implement broad relief programs such as income-based repayment plans, near-universal pandemic forbearance, and loan forgiveness.[20]
- **Auto lending ($1.50 trillion in balances as of Q2 2022)** differs because lenders can repossess the vehicles that secure the loans. The importance of transportation to borrowers' ability to work and maintain their daily lives also heightens incentives for repayment.[21]
- **Mortgage lending ($11.39 trillion in balances plus $.32 trillion in home equity lines of credit as of Q2 2022)** is secured by borrowers' houses, which can be subject to foreclosure. The market is subject to extensive laws concerning servicing and recovery processes, and federal agencies and government-sponsored enterprises can impose process and substantive requirements for workouts of loans they securitize or insure.[22]

Although general unsecured lending may be somewhat smaller than these other markets,[23] it has critical impacts on them and on the nation's broader economy. Credit cards are often the first type of loans that consumers take out when building a credit history, becoming a gateway to help qualify for other products.[24] Most households that go on to take out other loan types continue to use credit cards, and they are often the first loans to go delinquent when consumers begin to experience financial distress.[25]

Available credit on cards can also have a significant effect on household spending and small business growth,[26] both of which are critical to the broader economy (See Section 2.1.3). For example, the build-up in credit card debt in the mid-2000s and rapid contraction of credit availability during the 2008 financial crisis may have contributed substantially to that downturn.[27]

2.1.1 The Life Cycle of Distressed Loans

Consumers who begin missing payment due dates face a series of escalating consequences. The first are penalty fees and interest rates, the size and timing of which depend on their loan contracts and applicable law. In the credit card market, late fees average $31 and interest rates may increase to 29 percent or more.[28] After a full billing cycle (typically 30 days), most lenders also report consumers as past due to credit bureaus, which can affect consumers' credit scores and the ability to access additional credit (See Section 2.1.3). Lenders also generally attempt to contact consumers via internal collections teams and/or first-party collection firms that operate under the lenders' names.[29] Where consumers show evidence that they are able and willing to make up a shortfall, banks under certain circumstances can "re-age" their accounts by returning them to current status before the borrowers have actually repaid all past-due principal, interest, and fees.[30]

However, where delinquencies continue to worsen over several months, lenders will often lower credit limits, close revolving accounts to new charges, and eventually charge off the loans by recording them as a loss (See Section 2.2.2). Federal banking guidance generally dictates that banks charge off closed-end loans after no more than 120 days' delinquency and open-end loans after 180 days.[31] Non-banks follow similar procedures and may use bank timelines particularly where they may sell loans to bank investors.[32] Charge offs are considered seriously derogatory events for credit scoring and underwriting purposes, and negatively affect lenders' balance sheets.[33]

After charge off, lenders are more likely to refer accounts to third-party debt collection agencies that collect under their own names or in some cases to sell debts to buyers that pursue their own recoveries. Such parties are often more aggressive in their contact attempts because they are not already known to borrowers and have no other relationship with them.[34] Federal rules that took effect in November 2021 have limited contact attempts to seven phone calls per week when a third-party collector is initially establishing "right-party contact" in connection with a particular debt and once per week after contact is established, as well as creating standards for the use of more modern technologies such as email and text messages.[35]

Lenders, collection agencies, or debt buyers may also sue the borrower in court seeking to garnish wages, take money directly from consumers' bank accounts, or seize assets. Across all types of debts and plaintiffs, available information suggests that collections litigation has at least doubled in recent decades.[36] More than 70 percent of the lawsuits result in a default judgment in the creditor's or collector's favor because the consumer does not participate, and only about 10 percent of consumers are represented by legal counsel.[37] Reviews of cases in various jurisdictions suggest that some borrowers who fail to appear for a hearing did not receive notification of the lawsuit or court dates.[38] The size of the debts relative to litigation costs may also influence consumers' decisions about whether to respond to particular lawsuits, although dollar amounts tend to be higher in credit card collections than for some other kinds of debt.[39]

After judgment, courts can authorize the garnishments of wages and bank accounts to repay the debt. Federal law limits weekly garnishments in most cases to 25 percent of disposable earnings (earnings after required deductions for taxes, social security, and federal benefits), and state laws may prohibit garnishments or impose additional restrictions.[40] All states allow the seizure of funds from bank accounts. Although federal rules provide some protections for deposits of federal benefits and some states restrict the seizure of deposits of wages, many have gaps and enforcement can be complicated. Some states have created exemptions to protect some bank account funds for basic necessities, but many of those thresholds are outdated.[41]

A small minority of debt collectors and holders may pursue (or threaten to pursue) additional actions, such as seizure of non-cash assets or the issuance of criminal warrants for consumers who fail to appear at post-judgment proceedings or to disclose information about their finances to be arrested for contempt of court. For example, across all types of collections actions, the American Civil Liberties Union estimates that more than one million consumers receive letters threatening criminal prosecution and jail time annually, although the actual issuance of warrants is in the tens of thousands and the number of executed warrants is even smaller. However, when they occur such incarcerations can affect future employment, housing, and education opportunities.[42]

2.1.2 Sources and Frequency of Distress

While the incidence of financial distress has deeper roots in the slower pace of income growth relative to such expenses as housing and health care over the last several decades,[43] research indicates that the immediate trigger for many episodes is an income or expense shock that either permanently changes a household's finances or strains its short-term ability to bridge gaps through savings, friends and family, or credit.[44] Job losses during national recessions are an obvious trigger, but distress levels are also affected by broader shifts in the labor market, localized disruptions, and personal events such as divorce or the death of a partner. Research suggests that U.S. households are becoming more vulnerable to such income and expense shocks over time, although the COVID-19 pandemic and relief efforts produced unusual patterns (See Section 4).

Most measures of household income volatility indicate that it has increased over the past several decades due largely to changes in labor markets, with more pronounced effects on low-income households, Black families, and single parents.[45] In 2019 surveys by the Consumer Financial Protection Bureau (CFPB) and the Federal Reserve Board, between a quarter and a third of respondents reported variations in monthly income, of which a third to a half reported having struggled to pay expenses.[46] Income volatility can stem from irregular work schedules, changes to public benefit programs or wages, and changes in the structure of a household.[47] For example, an increasing number of Americans are participating in the gig economy due to personal preferences for more flexible hours as well declines in the number of jobs with stable schedules, particularly for lower-income workers.[48] Surveys suggest that income shocks tend to have a substantially larger impact on consumers' subjective feelings of financial stability than expense variations.[49]

The increasing frequency of extreme weather events and natural disasters due to climate change also affect households' financial stability.[50] These disasters can cause damage to or loss of property, interruptions in employment, and in some cases surging utility prices, all of which hurt families' ability to pay bills.[51] About 16 percent of respondents to a 2021 Federal Reserve survey reported experiencing hardships in the past 12 months in connection with natural disasters, and various studies have documented increases in bankruptcy filings, mortgage delinquencies, and negative credit card outcomes for at least some populations in the aftermath of various disaster events.[52] Impacts are also spreading to areas that traditionally have not been required to purchase flood or other disaster insurance, which can further increase economic and financial hardships in the aftermath of major storms.[53]

Medical issues also remain a major driver of financial distress, not only due to increased expenses but also because of lost income during the illness or injury of a consumer or a household member. While the number of medical debts in collection and bankruptcy filings among lower income consumers appear to have declined since the Affordable Care Act,[54] surveys have found that when income-related effects are included two-thirds of bankruptcy filers still cite medical issues as a contributing factor.[55] Even prior to the COVID-19 pandemic, surveys suggested that between 20 and 25 percent of consumers experienced major unexpected medical expenses annually and that roughly 50 percent reported a broader range of medical financial hardships, including forgone or delayed care and worry about medical bills.[56]

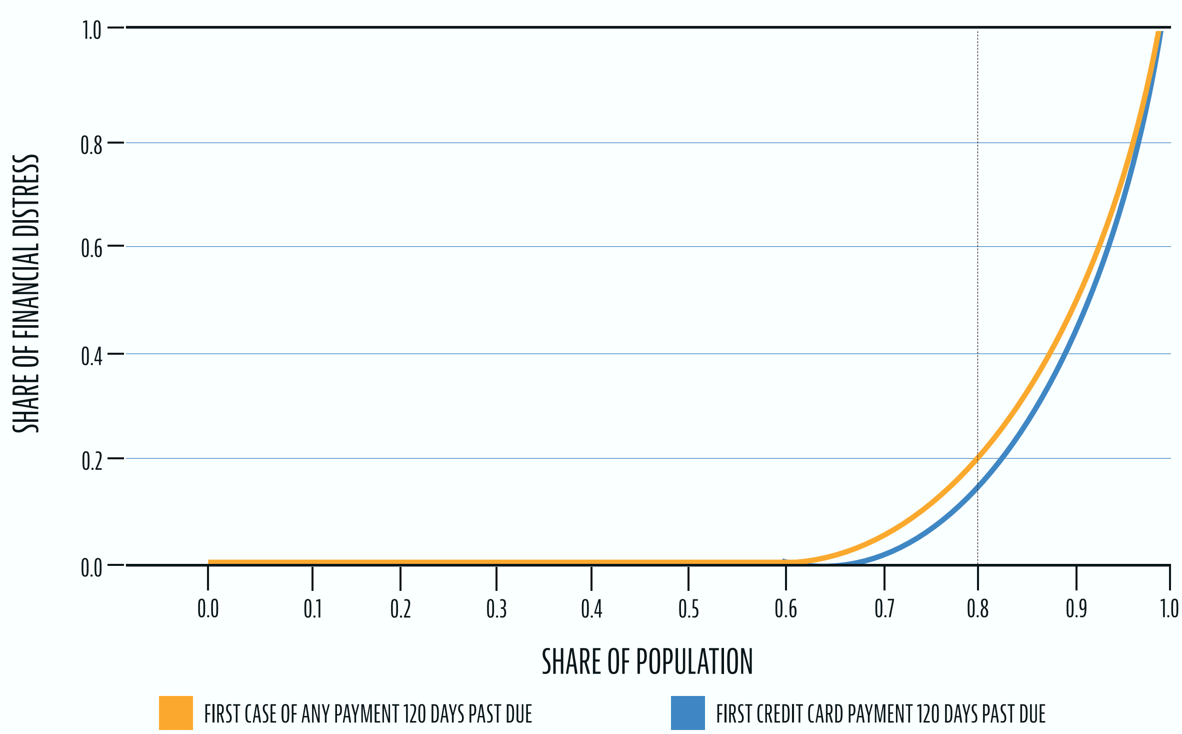
Lower savings rates also make it harder for households to absorb shocks when they occur. Personal savings rates declined from an average of roughly 10 percent in the mid-1980s to less than 3 percent heading into the 2008 financial crisis.[57] While metrics improved somewhat after that downturn, a Federal Reserve survey in 2019 found that only about 50 percent of consumers had specifically set aside money as emergency savings or a "rainy day" fund.[58] Such funds were even less common among households with less than $40,000 in income (about a quarter), renters (about a third), and Black and Hispanic households (less than 40 percent).[59] A CFPB survey the same year found that 20 percent of respondents reported they would be able to cover a primary loss of income for only two weeks and 38 percent for less than a month by exhausting cash and savings, selling assets, turning to friends and family, and borrowing.[60]

Over the last several decades, consumers have increasingly turned to credit cards to maintain their standards of living and bridge gaps in income and expenses,[61] in some cases even when they do have modest savings on hand.[62] However, access to credit often becomes more expensive and difficult to obtain as households' financial situations deteriorate (See Section 2.1.3 and Section 2.2.1). The volatility of credit limits is also higher than most estimates of income volatility, as card issuers periodically re-underwrite accounts in response to borrowers' changing financial conditions, broader economic indicators, and cost factors. For example, issuers often reduce credit lines during broad economic downturns, which can reduce the risk that consumers default on card payments yet can also temporarily depress consumers' credit scores and spending in the broader U.S. economy.[63] Surveys suggest that the amount of available credit on credit cards and available assets are both significant factors in consumers' psychological stress levels, in addition to credit card balances and other unsecured debt.[64]

Research suggests that about a third of consumers are likely to experience at least one serious loan delinquency in their lifetimes, while a smaller group experiences more intense and longer- term periods of distress. Analyses of data from 2004 to 2013 suggest that the majority of consumers who go 60 to 90 days delinquent in one quarter on unsecured loans are able to resume making payments within the next quarter to avoid worsening their delinquency levels.[65] Nevertheless, a study of adults with at least ten years of credit bureau history between 1999 and 2016 found that about 35 percent had experienced a 120-day delinquency on at least one credit account, with credit card delinquencies constituting the largest category by far.[66] Among those who experienced at least one such loan delinquency, about 40 percent were distressed for at least a quarter of the observation period, and about 10 percent experienced at least three episodes of distress. Overall, more than half of the 120-day delinquencies were concentrated among roughly 10 percent of the sample population.

About one in eight consumers have experienced sufficiently intense financial distress that they have filed for bankruptcy, and about eight percent of bankruptcy filers overall are estimated to seek repeat relief (See Section 2.2.5).[67] Both bankruptcy and foreclosure research suggest that some consumers experience negative effects for at least a decade after those events.[68]

FIGURE 1 CONCENTRATION OF DEBT DELINQUENCY



Note: This figure shows the portion of total delinquency accounted for by every population centile over the period 1999-2016. The x-axis orders the population from least financial distress to most.

Source: Federal Reserve Bank of St. Louis. How Persistent Is Financial Distress? (November 2018).

2.1.3 The Consequences of Financial Distress

Beyond the immediate challenges of weathering financial shocks and deciding whether and how to address delinquent loans, many households face lingering effects from past periods of distress even after their finances have started to improve. These spillover effects can have important implications for individuals' future financial stability and wealth building activities, as well as for their employers, neighborhoods, and the broader economy (See Box 2).

One major consequence of past financial distress is the effect that higher utilization rates, delinquencies, and other derogatory events can have on consumers' credit reports and scores. Negative payment history generally remains on credit reports for seven years, and certain bankruptcy information for ten years.[69] Credit scoring models assign varying weights to this information depending on such factors as the consumer's previous history, the recency of the event, its severity, and the number of accounts affected.[70] A single 30-day delinquency can cause a large immediate drop in scores for consumers with previously pristine records, but little change for consumers with several past delinquencies.[71] The impact of a single 30- or 60-day delinquency will begin to decrease within a few months and more substantially within a few years depending on the consumer's initial credit score,[72] but more serious derogatory information tends to have larger, longer-lasting effects on scores and may be assigned additional weight by individual lenders.[73]

Access to future credit can affect households' ability to improve their long-term finances by obtaining reliable transportation, purchasing homes, and investing in small businesses.[74] Even when previously distressed borrowers are approved for new credit, they may face higher prices due to a practice called risk-based pricing. A 2019 CFPB report found that consumers with credit scores below 580 saw interest rates on revolving credit accounts that were nearly six percentage points higher than the average effective interest rate.[75] Similarly, consumers with lower scores pay thousands of dollars more in interest on installment loans such as auto loans and mortgages.[76] Proponents argue that risk-based pricing helps higher-risk consumers obtain credit by allowing lenders to cover their risk of increased losses, while critics argue that the higher pricing increases the likelihood that affected borrowers cannot repay their loans.[77]

Credit reports are also often used for employment and tenant screening, setting utility security deposit requirements, and underwriting some forms of insurance.[78] While public employers are prohibited under federal law from refusing to hire applicants or discriminating against existing employees based solely on bankruptcy filings, protections are often narrower with regard to private employers.[79] Similarly, private landlords may also refuse to rent to tenants or require larger deposits from applicants who have had past delinquencies or more serious derogatory items on their credit reports.[80]

Research also suggests that individuals with higher debt levels and other financial stressors are more likely to experience declines in physical and mental health, cognitive performance, marital relationships, and work productivity, all of which can potentially prolong or exacerbate financial problems.[81] For example, studies have found that financial stress increases the value that consumers place on immediate payoffs relative to future payoffs and reduces the effort they are willing to make to learn about financial decisions, both of which could affect decisions about borrowing and repayment.[82] Financial distress is also associated with marital troubles, potentially further eroding borrowers' emotional support systems and financial stability.[83]

The ability to rebound from financial distress has significant ramifications not only for individual households' financial and general health, but also for their employers, neighborhoods, and the broader U.S. economy. Estimates about the cost of lost productivity to employers relating to employees' personal financial problems range as high as $500 billion annually, with surveys indicating that

BOX 2 HOW TO DEFINE AND MEASURE RECOVERY

Many policy debates and research studies focusing on financial distress and recovery tend to focus on credit scores, credit reports, or access to credit more generally as a primary measure of households' evolving financial situations. This is driven by several factors, including the relative availability of the data, the fact that credit reports are used to screen applications across several different sectors, and the heavy reliance on credit to invest in activities such as homeownership and small business formation to improve households' long-term financial capacity.

At the same time, it is important to recognize the limitations of such measures. Credit scores and reports do not provide a full picture of consumer finances, since they do not directly reflect income types of credit. They are used in different ways by different companies, and are often not the only information considered.[84] More broadly, restored credit access may not always signal or lead to long-term improvements in financial health, particularly if chronic shortfalls and future shocks prompt consumers to again accumulate unsustainable balances of general unsecured credit.

The CFPB, Financial Health Network, and other organizations have developed more comprehensive metrics for measuring households' financial health and stability using both subjective and objective components.[85] However, collecting sufficient information from consumers to apply such metrics in the debt resolution context remains challenging.

as many as 80 percent of employers report that financial stress is at least "somewhat impactful" on job performance.[86] Studies also show that serious credit card delinquencies are twice as prevalent in low- and moderate-income neighborhoods as in middle- and high-income neighborhoods, and three times as likely in majority-Black neighborhoods.[87] The frequency of collections items in credit reports and filings of collection lawsuits are also substantially higher for households living in lower-income and majority-minority areas.[88]

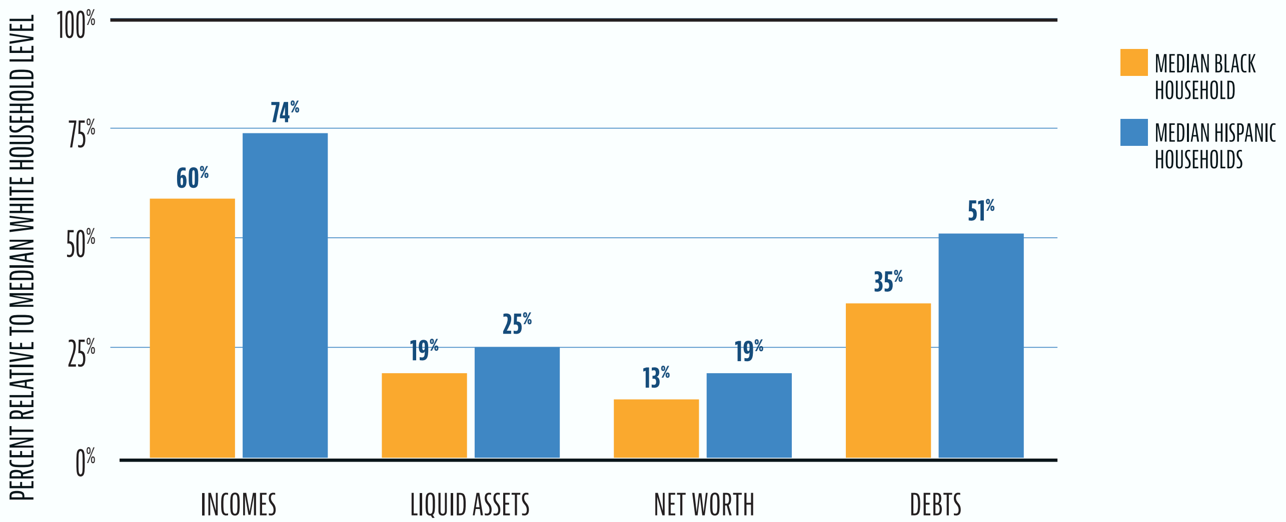
More broadly, constraints on households' ability to access credit and engage in wealth-building activities can have important implications for the broader U.S. economy, given that consumer spending constitutes two-thirds of gross domestic product and that 60 percent of net new jobs are created by small businesses.[89] For example, studies suggest that efforts to stimulate consumer spending after the 2008 financial crisis by reducing the cost of credit had limited effects because banks largely only expanded access for consumers with high credit scores.[90] Research also shows that smaller businesses are more likely than larger companies to rely on owners' personal credit scores and access to personal credit products for loan access,[91] which in turn has positive correlations with job formation and revenue growth.[92] As discussed in the next section, the incidence and mechanisms for recovery from past financial distress also have important implications for the nation's longstanding racial wealth gaps.

2.1.4 Heightened Policy Concerns for Communities of Color

Historical discrimination in lending, employment, education, housing, and other sectors have helped to create disparities in median incomes, liquid assets, and other financial metrics among households of color (See Figure 2).[93] These in turn tend to increase relative debt burdens and vulnerability to financial distress. Although Black and Hispanic families hold smaller amounts of debt on average than White families, they are more likely to revolve credit card balances and carry substantial educational debts.[94] For median households, debt-to-asset ratios are at least 50 percent higher than median White households, leaving less to fall back on when income or expense shocks occur.[95]

Such disparities also affect reliance on social networks for financial assistance. A 2019 Federal Reserve survey found that 72 percent of White respondents reported that they could borrow $3,000 from friends and family, compared to 41 percent of Black and 58 percent of Hispanic respondents.[96] In a CFPB survey the same year, 15 percent of Black and Hispanic respondents reported that they

FIGURE 2 DISPARITIES IN INCOMES, ASSETS, AND DEBT LEVELS AS OF 2019 BETWEEN MEDIAN BLACK, HISPANIC, AND WHITE HOUSEHOLDS



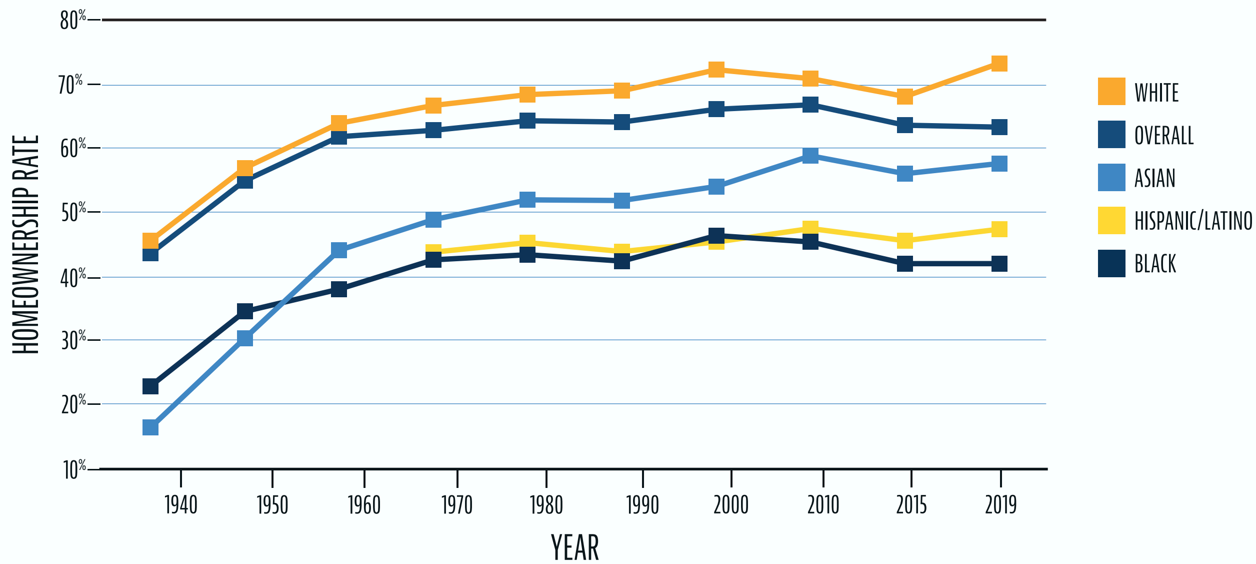
Sources: Semega et al. (2021); Bhutta et al. (2020); Federal Reserve Board, Survey of Consumer Finances 1989-2019 Interactive Chartbook, Debt by Race or Ethnicity.

encountered a significant unexpected expense due to assisting friends or family, compared to 10 percent of White respondents.[97]

In light of these statistics, it is not surprising that various studies show racial disparities in distress levels and delinquencies.[98] For example, in the 2019 CFPB survey, 65 percent of Black respondents and 47 percent of Hispanic respondents reported that they had difficulty paying at least one bill or expense in the prior year, compared to 35 percent of White respondents.[99] The frequency and length of loan delinquencies are worse among families whose heads of households are younger, have less education, or are Black or Hispanic relative to families with older, more highly educated, and White heads of households, respectively.[100] Black and Hispanic consumers are more likely to have collections items on their credit reports than White consumers,[101] and there are significant disparities in bankruptcy filings and outcomes for Black consumers (See Section 2.2.5).

These patterns contribute to substantial racial disparities in credit scores,[102] which in turn increase the cost of making long-term investments in homeownership and small business formation.[103] Consumers' options for resolving delinquent debts and recovering from past periods of financial distress thus have important implications for efforts to close the nation's longstanding racial wealth gaps.[104] Consumers' options for resolving delinquent debts and recovering from past periods of financial distress thus have important implications for the fairness of the credit system and efforts to close the nation's longstanding racial wealth gaps.[105] At the same time, mortgage lenders increased their minimum score requirements. Studies focusing on transitions to homeownership between 2012 and 2018 found that at least two-thirds of gaps for Black and Hispanic applicants as compared to White applicants could be explained by credit scores and related attributes.[106] By the end of the decade, the Black-White homeownership gap had reached 50-year highs, worse than when fair housing and fair lending laws were enacted in the 1960s and 1970s.[107]

FIGURE 3 HOMEOWNERSHIP RATES BY RACE SINCE 1940



Source: National Community Reinvestment Coalition. 60% Black Homeownership: A Radical Goal For Black Wealth Development (March 2021).

2.2 Overview of Debt Resolution Options

Although some consumers leave past delinquencies unresolved (which is sometimes called insolvency or informal bankruptcy), [108] borrowers who decide to seek relief have had five primary alternatives historically. These include (1) applying for a debt consolidation loan from a new lender; (2) asking for assistance from their current lenders; (3) working with a nonprofit credit counseling agency to set up a multi-lender debt management plan; (4) enrolling with a for-profit debt settlement company that will seek less-than-full-balance (LTFB) settlements from their lenders; or (5) filing for bankruptcy to resolve nearly all of their debts.

However, not all of these options are available to all consumers, and each alternative has potential tradeoffs as to the timing and amount of direct costs, effects on credit reports and scores, and other considerations. Moreover, because consumers often have several unsecured credit accounts,[109] it may be difficult for any single lender acting alone to provide enough payment relief to enable consumers to stabilize their broader finances. Trying to coordinate among multiple parties can be complicated for lenders and borrowers alike, particularly where consumers are also struggling to find new jobs or manage other underlying hardships.

As a result, some options involve different types of intermediaries that interface between consumers and multiple creditors. At their best, these specialists can make the coordination and resolution process more efficient and more effective, while at their worst, they can lead to substantial delays and costs on top of an already complicated set of communications and negotiations. In practice, coordination challenges and competitive dynamics between market actors can further complicate what options are available to individual consumers and the processes they must follow to obtain relief. As discussed further in Section 3.2.3, some new fintech companies have emerged, seeking to provide both business-to-consumer and business-to-business platforms to address gaps in the broader market.

TABLE 1 OVERVIEW OF DEBT RESOLUTION OPTIONS

OPTION	DESCRIPTION	ELIGIBILITY AND ENROLLMENT	IMPACT ON CREDIT SCORES AND ACCESS	OTHER BENEFITS, COSTS, AND RISKS
DEBT CONSOLIDATION LOAN	A loan or credit line used to pay off multiple existing debts. May be unsecured or secured by home equity in some cases.	Criteria vary by lender. Pricing and availability worsen as consumers' credit scores and financial situations deteriorate.	New loan may have a brief negative effect on scores. May also be treated as negative if consumers run up credit card balances again.	Offers a single lower monthly payment but effect on overall cost of credit depends on rates and fees.
BILATERAL LENDER WORKOUTS AND SETTLEMENTS	Long-term options may include full principal repayment plans that waive some interest and fees as well as LTFB settlements.	Criteria vary by lender. Prior to charge off, banks generally offer only to consumers who can pay all principal in 60 months or a settlement in 3 months.	Depends on type and reporting codes used; codes for LTFB settlements are treated as negative by some scoring models. Original accounts are often suspended or closed.	Borrower must work with each lender individually. LTFB settlements may have tax consequences.
DEBT MANAGEMENT PLAN	Multi-lender full principal repayment plans that waive some interest and fees. Usually administered by nonprofits.	Sufficient residual income to pay full principal in 60 months. About 50% of counseled consumers do not qualify.	Codes are not treated as negative, but closing of original accounts may cause initial decline. Opening new accounts is discouraged.	Consumer fees may be $1,000 to $2,000 depending on state and agency. Not all lenders participate in DMPs.
DEBT SETTLEMENT COMPANY	For-profit DSCs seek LTFB settlements from individual lenders. Process and payments may take up to 4 years.	Criteria vary by DSC. Large DSCs typically require at least $10,000 to $15,000 in debt and steady income.	Credit score declines are often substantial when consumers stop lender payments. Codes for LTFB settlements are treated as negative by some scoring models.	Balances often grow initially. Fees are often 15-25% of settled debt. LTFB settlements may have tax consequences. Lenders' willingness to work with DSCs varies and some may file suit if communications are cut off.
CHAPTER 7 BANKRUPTCY	"Liquidation plan" administered by trustee. Requires significant assets to be surrendered but discharges most debts in 6 months.	Means-tested based on state median family income. Accounts for about 60-70% of bankruptcy filings.	Treated as negative and stays on credit report for 10 years. New loans often carry lower limits and higher prices.	Costs average $1,800 and are typically paid upfront.
CHAPTER 13 BANKRUPTCY	"Wage earner's plan" administered by trustee. No asset surrender but must pay for 3-5 years to obtain discharge. Discharges more types of debt than Chapter 7.	Sufficient residual income for payments, plus debt below certain statutory thresholds.	Treated as negative and stays on credit report for 7 years. Approval is needed to open new credit during repayment plan.	Costs average $3,300, but may be paid over time. Up to two thirds of filers do not actually obtain discharge of debts.

The resulting landscape is thus extremely complicated for both individual consumers when choosing between debt resolution options and for policymakers and other stakeholders when working to develop better tools for recovery. Data and research are limited, and methodological issues further complicate comparisons of outcomes. For example, isolating the effects of a particular option from the effects of underlying sources of financial hardship can be difficult, and many consumers may try multiple alternatives in the course of attempting to stabilize their finances. There can also be significant self-selection issues, for example if certain internal motivations both cause consumers to be more likely to choose a particular option and influence what actions they take once enrolled. In such cases, differences in outcomes might be due to motivational drivers rather than the nature of the debt resolution option.

This section provides a description of the basic mechanics of each of the historical debt resolution channels and an overview of available research about participants and outcomes. Section 3 and

Section 4 describe market, regulatory, and technology developments that have helped to shape this ecosystem over the past two decades , including the emergence of new fintech actors as discussed in Section 3.2.3 and pandemic-era developments as discussed in Section 4. Appendix A provides additional information about credit counseling, secured credit cards and credit builder loan programs, and credit repair organizations. Although the latter options do not provide a specific structure for resolving past debts, they are also a part of the broader ecosystem since consumers may turn to these options for more generalized advice and assistance in rebuilding their credit after past periods of financial distress.

2.2.1 Debt Consolidation Loans, Home Equity Loans, and Other Refinancing Options

One option for some consumers who are becoming overextended on their existing credit accounts may be to seek out a debt consolidation loan, home equity loan, or other refinancing option that will reduce monthly payments relative to the original individual loans. In addition to lower monthly payments, this option can be appealing because a single loan can be easier to manage than multiple accounts yet does not require borrowers to commit to forgoing further access to credit, pay fees to intermediaries, or take actions that have substantial long-term effects on their credit reports and finances.

However, as consumers' credit scores and general finances deteriorate, new loans often become increasingly expensive and difficult to obtain. Research is limited but also suggests that refinancing options may in some cases exacerbate rather than relieve existing distress if the loans add to the overall costs of credit or if consumers continue to increase their debt levels after consolidation.

2.2.1.1 Basic Mechanics

Consolidation loans allow borrowers to pay off multiple existing debts by taking out a new installment loan.[110] A single loan with a fixed rate and lower monthly payment can be easier to keep track of and more predictable than multiple credit card debts. Particularly compared to making minimum credit card payments, installment loans can also potentially offer substantial savings, although the length of the loan, rate structures, and amount of fees can affect overall costs.[111] Debt consolidation loans are offered by banks, credit unions, traditional finance companies, and newer "fintech" or "marketplace" lenders that operate via online platforms. That latter segment became the single largest source of personal loans in 2016, in large part by marketing to consumers who were seeking ways to reduce burdens associated with accumulated credit card debt.[112]

For homeowners, another option may be to pay off existing credit accounts by taking out a loan that is secured by their home equity.[113] Home equity loans often have a substantially lower interest rate than unsecured debt and thus result in lower monthly payments. These loans are especially popular when housing values are rising as a way for consumers to convert growing equity to cash, yet they can also have drawbacks such as closing costs, the risk of going "underwater" if the value of the home later drops, and the risk of foreclosure for missed payments.[114]

While consolidation and home equity loans can be appealing to borrowers who are carrying high levels of personal debt, borrowers may be charged higher prices or rejected as their financial distress increases. In addition, the effects of opening additional accounts on consumers' credit scores can vary. Because of the popularity of marketplace lending and debt consolidation loans, some credit score developers have recently announced changes to their models that are designed to assess whether use of consolidation loans signals increased risk that a consumer is likely to default. In situations in which consumers take out a consolidation loan and then rapidly run up their credit card balances again, for example, some scoring models will lower their credit scores.[115]

2.2.1.2 Overview of Research

Research is limited on the use of debt consolidation loans and home equity credit products to refinance unsecured debts, and available studies do not distinguish between consolidation loans taken out by households seeking to avert or resolve an inability to repay from those taken out by consumers simply seeking to lower their payments. While the potential financial benefits of consolidation loans depend on their pricing and length, advertisements that emphasize monthly payment relief may cause consumers to overlook the fact that some loans can increase overall credit costs.[116] Some studies also suggest that consumers may be hesitant to take out consolidation loans because they are not confident about their ability to determine which products are helpful.[117]

More broadly, research on the build-up of home equity lending before the 2008 financial crisis and the impact of new marketplace lenders over the last decade highlight that for some consumers, consolidation loans and other refinancing options become additive rather than providing a path to wind down higher-cost debt. Not surprisingly, these risks may be higher for more financially vulnerable consumers and for loans that carry higher rates, although as described below some research suggests that other behavioral factors may also be at play.

The pre-crisis research shows that many households capitalized on rising housing values to pay down debt through home equity lines of credit and cash-out refinances. At the peak of the real estate boom in 2006, for instance, some analyses estimated that consumers retired about two percent of outstanding nonmortgage debt ($175 billion) by borrowing against their homes.[118] Although consumer advocates pointed to research finding that as many as 70 percent of consumers who used home equity to pay down credit card debt subsequently ran up their balances again, marketing of cash-out refinances as a way to pay down credit card debt continued to increase and was heavily targeted to subprime households. By 2007, at least 82 percent of subprime refinances were cash-out transactions, compared to 47 percent of prime refinances.[119]

Tighter credit criteria, loan-to-value limitations, and other changes after 2008 reduced the number of consumers who used cash-out refinancing and home equity lines of credit (HELOCs) to extract wealth from their homes. Borrowers who have continued to use this strategy tend to be older and have higher credit scores.[120] Comparing 2006 to 2017, some research suggests that borrowers who took out HELOCs in the later era were achieving larger reductions in their credit card and student loan debt compared to borrowers who had taken out HELOCs in the earlier period.[121]

Studies of marketplace lenders vary depending on the particular lenders and data sources. Several find that roughly 70 percent of their customers report they are seeking to consolidate debts or repay credit cards, although one study finds that the actual use of proceeds for this purpose averages about 44 percent.[122] Not surprisingly, given their interest in debt consolidation, marketplace borrowers tend to have higher unsecured loan balances and higher credit utilization ratios than the U.S. population as a whole, and some studies find that they have twice as many credit cards and credit scores that are about 20 points lower than the national average.[123]

Several studies provide evidence that marketplace consolidation loans can offer pricing advantages over credit card debt for a subset of borrowers, in addition to the more general structural advantages of a single consolidated payment for a set term.[124] However, while borrowers' credit card balances, utilization ratios, and credit scores tend to improve significantly within a few months of origination, research suggests the long-term effects depend in part on how much of the loan proceeds in fact go to consolidation and on whether borrowers rapidly incur additional credit card balances or other new debts. For example, one study found that marketplace borrowers who use 100 percent of their proceeds for consolidation experience score increases of 40 points after two years relative to borrowers who use none of the proceeds for that purpose.[125] Research also suggests that marketplace borrowers tend to take on more debt over time, but studies differ as to the types of debt incurred and whether delinquencies increase relative to various comparison groups. At least for some consumers, they suggest that consolidation loans can increase risk of default and bankruptcy if they become additive rather than replacing higher-cost debt.[126]

Taken as a whole, the research suggests that consolidation loans can work for some consumers but can risk exacerbating rather than relieving debt burdens and financial distress for others. Such risks are likely higher for more financially vulnerable consumers and for more expensive loans, but additional research could be helpful to better understand what other factors may be shaping outcomes and where this resolution option is not likely to help consumers stabilize their finances.

2.2.2 Bilateral Lender Workouts and Other Accommodations

Another option for borrowers struggling to repay unsecured loans is to seek an accommodation from one or more of their existing lenders to help them stabilize their finances while paying off at least some accumulated debt. Such bilateral relief can take a variety of forms, ranging from temporary payment holidays and interest rate reductions to long-term workouts and settlements. Lenders' policies vary as to which kinds of relief they are willing to provide in different circumstances, whether and when they affirmatively reach out to consumers to offer workout options, and how much information they make publicly available. Public research on the scope and efficacy of these programs is also extremely limited.

Interviews and surveys suggest that some lenders may be more willing to grant larger concessions in direct workouts, and such arrangements in any event do not require paying fees to an intermediary for their services. However, the lack of public data makes the costs of bilateral workouts hard to evaluate relative to other options, and several dynamics can complicate the negotiation process. Consumers who are already delinquent may be distrustful of sharing information with lenders for fear that it will disadvantage them, and they may be overwhelmed with trying to manage multiple negotiations. Individual lenders may also limit the information they make available about their programs and the structure of their offerings due to fear of encouraging "moral hazards" and applications by consumers who can actually afford repayment (See Box 3) and regulatory and investor considerations (See Box 4).

2.2.2.1 Basic Mechanics

Not all lenders offer workout programs; for instance, interviews indicate that many fintech and marketplace lenders did not have them prior to the pandemic. Although some have since gone on to develop options, there may be contractual limits as to how much flexibility a lender can provide to borrowers on an existing loan that has already been securitized and sold to investors.

Traditional installment lenders and banks are more likely to offer structured workout alternatives, but in the latter case the options they offer are specifically designed to account for regulatory guidance concerning the treatment of impaired loans (See Box 4).[127] These structures have important implications for what relief banks make available to borrowers at particular stages of distress, as well as for options provided by credit counseling agencies and debt settlement companies in dealing with banks (See Section 2.2.3 and Section 2.2.4, respectively). For example, for accounts that have not yet charged off, the guidance discourages banks from offering workout plans that last more than 60 months or from agreeing to less-than-full-balance settlements that cannot be completed in three months. Banks have substantially more flexibility after charge off, though by that time the borrower may have accrued substantial interest and fees on their delinquent debt and/or moved on to other debt resolution channels.

BOX 3 MORAL HAZARDS, STRATEGIC BEHAVIOR, AND FRAUD IN DEBT RESOLUTION

In lending and insurance, moral hazard is broadly defined as the lack of incentive to guard against a particular risk (or the incentive to engage in greater risk-taking) where an actor is protected from that risk's consequences.[128] Considerations about moral hazard, strategic behavior, and fraud can play a significant role in the design and implementation of debt resolution options, for instance due to concerns that the existence of relief programs or certain features might encourage borrowers to take out more debt initially, to be less careful in managing their ongoing finances, or to withhold loan payments that they would otherwise make. Particularly where relief programs involve government subsidies, there can also be concerns about moral hazards and strategic behavior by lenders or other industry actors.[129]

Designers of debt resolution programs thus often face a series of tradeoffs in deciding how and when to provide information about workout options, the extent of hardship documentation requirements, and how and when to provide actual relief, since actions that are designed to reduce moral hazards and strategic behavior can also create obstacles for borrowers who are in true distress. For example, requiring extensive paperwork may discourage fraud and applications by borrowers who actually could afford to pay their loans, but may also be difficult for borrowers who are struggling to resolve legitimate underlying hardships. Program designers may strike one balance in the context of large exogenous shocks, such as a recession or a natural disaster, but a different one in dealing with more individualized circumstances.

Policy debates and research about these issues have increased in response to both the 2008 financial crisis and the pandemic. For example, although the mortgage market has long been concerned about "strategic defaults" by borrowers who stop paying their loans where the market value of the property has fallen below the amount owed, several post-2008 studies suggest that income shocks are a more significant factor.[130] Recent survey data analyzed in a staff working paper by a researcher at the Consumer Financial Protection Bureau also suggest that health events, divorce, and expense shocks that are unobservable in most traditional data sources explain a large additional portion of mortgage defaults.[131]

Pandemic-era experiences are also fueling debates on these topics. While concerns about fraud in the Paycheck Protection Program and state unemployment benefits systems continue to grow,[132] it is notable that a substantial number of borrowers who obtained forbearances continued to make timely loan payments, presumably because their circumstances were not as dire as initially feared. The percentage was highest on secured loans, including 25 percent of mortgage forbearances and 23 percent of vehicle loan forbearances, but also 19 percent on credit cards (See Section 4.1).[133]

Lenders also vary in how and when they communicate with borrowers about workout options, in part due to concerns about encouraging strategic behavior. While large credit card issuers have policies to reach out affirmatively to consumers who meet standardized risk criteria,[134] other lenders may wait for borrowers to ask for help. Lenders' practices may also vary as to what kinds of hardship and financial documentation they collect from consumers in connection with workouts.[135] Where they already have access to credit report information in connection with ongoing account monitoring, lenders often feed such information into algorithms to predict the likelihood that a consumer will repay some or all debt. The most sophisticated prediction processes may be similar to what is performed for new applicants in underwriting credit, albeit with a different focus of analysis, but other lenders do not engage in a full analysis of borrowers' ability to repay when offering particular accommodations.

Short-term programs generally involve payment holidays or reductions in rates and fees while consumers stabilize their finances after an injury or other temporary disruption. For open-end credit such as credit cards, lenders may reduce credit limits or suspend the account until the borrower has been able to catch up. Such short-term programs generally do not change the terms of the loan, so borrowers will eventually have to pay off their balances.[136] Long-term forbearance and permanent loan modifications are generally used for more significant hardships that are expected to impact a borrower's ability to make payments over more than a year. For open-end loans, they are often structured to close the account and use an installment structure to pay down the balance. Closed-end

BOX 4 FEDERAL GUIDANCE ON BANKS' IMPAIRED DEBT

Most federal banking guidance on impaired debt dates from the early 2000s, although the Office of the Comptroller of the Currency (OCC) has issued some more recent guidance that applies to the nation's largest credit card issuers.[137] The guidance focuses primarily on ensuring transparency as to the state of the banks' finances and adequate loan loss reserves to protect their safety and soundness in the event that borrowers do not repay, though some documents also note that some banks' previous practices actually made it harder for borrowers to recover from financial hardships.[138] The guidance shapes banking practices in several ways:

- Recording losses: It directs banks to record actual credit losses when they become aware of the losses and to charge off delinquent loans after no more than 120 days for closed-end loans and 180 days for open-end loans. It also creates a tiered classification system for describing the extent to which a debt is impaired.[139] Banks must hold certain reserves against impaired loans, and those contributions are treated as expenses for accounting purposes.[140] Charged off loans and any subsequent recoveries also affect the balance of loan loss reserves.
- Re-aging delinquent loans: The guidance allows banks to "re-age" the loans by returning them to current status before all overdue amounts have been repaid in cases where delinquent borrowers "demonstrate a renewed willingness and ability to repay the loan," make three consecutive payments or pay an equivalent lump sum, and certain other conditions are met. But the number of re-ages on open-end loans is limited to once in twelve months and twice in five years, with one additional re-aging allowed for loans that enter a workout program with the bank or via a debt management program operated by a counseling agency (See Section 2.2.3).[141]
- Workout programs: The guidance directs that longer-term workout programs "should generally strive to have borrowers repay credit card debt within 60 months," with any timing exceptions "clearly documented and supported by compelling evidence that less conservative terms and conditions are warranted."[142] Noting that some banks previously appeared to have designed their programs to maximize income recognition and defer losses, the guidance states that workout programs should be designed to maximize repayment of principal even if interest rates and other charges have to be cut substantially.
- Less-than-full-balance settlements: Where lenders agree to settle an account for less than full balance, the guidance directs that the forgiven amount be recorded as a loss.[143] After the 2008 financial crisis, the OCC further directed that pre-charge-off LTFB settlements should be structured so consumers make all payments within three months. Agency officials say that the guidance was motivated by concerns that longer plans were being used to defer losses in ways that actually had negative impacts on consumers. Post-charge-off settlements are not subject to specific timelines since those loans have already been classified as losses.[144]

Banks have built their internal systems around this accumulated guidance over the past two decades, and varying from it can involve programming costs, financial consequences, change management challenges, and examiner scrutiny.[145] While the OCC recently provided guidance to examiners in working with banks that want to test 72-month workout structures,[146] broader uncertainty about the consequences and costs of specific changes complicates innovation. Compliance considerations can also be a factor, particularly given that there is no general formula or benchmark for evaluating potential principal reductions.[147]

As a result of these and other considerations, banks' pre-charge off options for debt resolution primarily focus on full balance workouts of up to 60 months and settlements of up to 3 months that average roughly 50 percent recovery in practice.[148] For consumers who cannot afford either of those structures, accelerating charge off to permit longer less-than-full-balance settlements is possible, but would have immediate effects on bank balance sheets and potentially on consumers' credit scores.[149] A far more common path is to wait to see if consumers can stabilize their finances, and if not to explore additional settlement options when charge off is required under the 120- and 180-day limits.

loans may be modified by lengthening the term of the loan to reduce monthly payments or to make up for missed payments. Lenders may also reduce interest and fees on both types of loans, though the size of concessions may vary depending on the lender and on the consumer's circumstances.

In more severe cases, lenders may agree to a settlement that forgives some of the balance in return for a partial repayment in a lump sum or over time, subject to the considerations discussed in Box 4 for banks.[150] While these settlements can provide the most relief to consumers, the written-off amount is subject to federal income tax if it exceeds $600 unless the consumer can show that he or she was insolvent.[151]

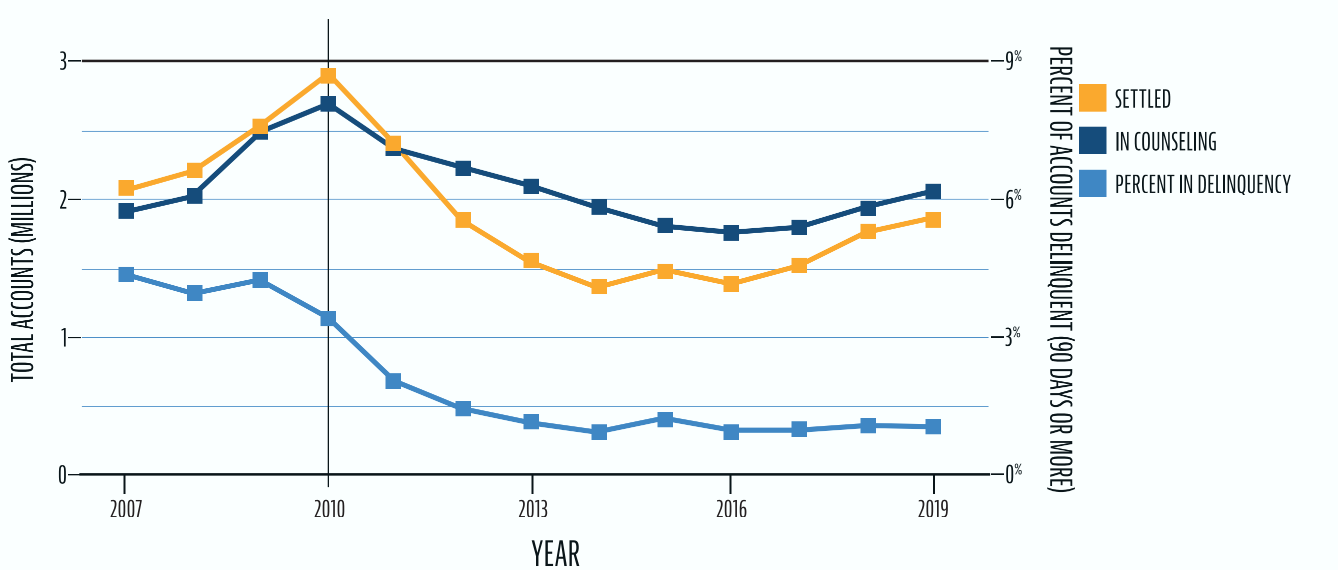
The effect of these programs on consumers' credit scores varies depending on the nature of the accommodation and whether and how the workouts are reported to credit bureaus. On the short-term end of the spectrum, some lenders use short-term flags for disaster-related hardships and forbearances, but widely used credit scoring models differ as to whether and how they consider such information (See Appendix C). At the other extreme, some credit scoring models treat codes for "partial payment agreements" and LTFB settlements as derogatory information that signals increased risk of future default and therefore lowers borrowers' scores. Settlements are not typically reported until they are complete.[152] With urging from advocates, industry and Congress took steps in connection with the 2008 financial crisis and the COVID-19 pandemic to reduce the impact of accommodations on consumers' credit scores (See Section 3.2.1 and Section 4).

2.2.2.2 Overview of Research

Public research on lenders' internal workout programs is limited, and sources that analyze credit bureau records struggle to differentiate settlements directly between consumers and lenders from those that involve debt settlement companies (See Section 2.2.4).

For example, a CFPB analysis used credit bureau data to track trends in LTFB settlements on credit cards and other unsecured credit during and after the 2008 financial crisis.[153] The analysis found that settlements occurred more quickly after initial delinquency during 2009 and 2010, leading to a peak of 3 million settlements affecting $12 billion in balances in 2010. During the post-crisis

FIGURE 4 COUNTS OF ACCOUNTS SETTLED OR IN A CREDIT COUNSELING PROGRAM EACH YEAR



Source: Consumer Financial Protection Bureau. Recent Trends in Debt Settlement and Credit Counseling (July 2020).

period, settlements began to rise again in 2016 as unsecured debt delinquencies also increased. However, patterns in the average balance settled and months of delinquency prior to settlement did not revert to crisis-era levels. More than 70 percent of the accounts settled had already been charged off by the time of settlement.

However, the analysis could not distinguish direct settlements between borrowers and lenders from those involving debt settlement companies (DSCs). Across the sample as a whole, consumers whose records showed at least one settlement averaged 1.6 settlements over three years, which is roughly half the average reflected in statistics released by certain large debt settlement companies (See Section 2.2.4).[154] The analysis thus cannot be used to estimate the overall volume, scale, or pace of bilateral or DSC settlements during the relevant time period.

Periodic CFPB surveys of several large credit card issuers do not provide industry-wide coverage but do distinguish forbearance programs and settlements directly between lenders and borrowers from settlements involving DSCs. The surveys indicate that the fraction of total delinquent balances that the respondent issuers "re-age" to current status without first collecting all overdue amounts has remained below two percent since 2017.[155] More than half of the issuer respondents reported that they had stopped offering distinct short-term forbearance programs over several years prior to the pandemic (See Section 4.1), and instead had simply been offering borrowers the opportunity to enroll in workout programs that were structured to repay all balances within 60 months regardless of the duration of their hardship. The percentage of pre-charge-off balances that are enrolled in internal workout programs and debt management plans administered by counseling agencies (See Section 2.2.3) has also remained below two percent for several years.[156]

With regard to settlements, the survey respondents reported average amounts of roughly 50 percent of the balances owed for both pre-charge-off and post-charge-off agreements.[157] In the 2020 survey, respondents reported that pre-charge-off settlements occur an average of 130 days past due and post-charge-off settlements occur an average of 443 days past the charge-off date, which is likely about 625 days past due. The percentage of pre-charge-off balances enrolled in settlements was less than half the enrollment rate for post-charge-off balances, at roughly .6 percent versus roughly 1.6 percent, respectively, prior to the pandemic. Thus, more than two-thirds of bilateral settlements occur after charge off.[158]

2.2.3 Debt Management Plans

With support from credit card issuers and retailers, nonprofit credit counseling agencies emerged in the 1950s and 1960s to help households struggling with multiple sources of unsecured debt. One of their key functions is to administer debt management plans (DMPs) to help borrowers who have unsecured debts with multiple lenders to pay off accumulated balances at the same time. Although lenders may waive some interest and fees, DMPs historically have been structured to repay all principal within three to five years, consistent with federal bank guidance (See Box 4) as well as some state law requirements (See Section 3.1.2).

As described below, available research suggests that consumers who participate in DMPs make greater debt reductions and faster credit score improvements than consumers with similar credit profiles who do not receive counseling or participate in the plans. However, a substantial number of counseled consumers do not qualify for DMPs because their finances cannot support full balance repayment within five years; while percentages vary among agencies and in different economic conditions, research and interviews indicate that roughly 50 percent of counseled consumers do not qualify for DMPs. Moreover, roughly 50 percent of counseling participants who meet eligibility requirements choose not to enroll. The length and cost of payments and limitations on credit access while participating in a DMP may make the plans less appealing.

This section focuses primarily on DMPs as they have been offered historically, although counseling agencies are now working to develop a broader range of debt repayment plan structures that would be available and potentially more appealing to a broader range of consumers (See Section 3.2.3 and Section 6).

2.2.3.1 Basic Mechanics

The parameters of DMPs are ultimately set by lenders, each of which specifies whether and under what circumstances they will participate and what concessions they will approve. Banks and traditional installment lenders will generally participate in DMPs, though they differ as to whether and when they will refer consumers to counseling agencies and a few impose restrictions such as only participating when all of a consumer's other unsecured creditors have also joined the DMP.[159] Non-bank fintech lenders who have not yet developed long-term internal workout programs generally do not join in DMP arrangements either, but some debt collectors and other non-lenders will participate in DMPs. Secured debts are excluded because of the possibility of repossession or foreclosure.

Lenders generally require DMP enrollees to pay a set amount of their balance each month plus a reduced interest rate, and most set different tiers of rate concessions depending on the level of the consumer's distress.[160] Some sources report that DMPs reduce average borrowers' monthly payments by 10 to 15 percent and their total cost of repayment by 20 to 40 percent.[161] Interest rate reductions and fee waivers may be made immediately upon enrollment or after the consumer has made three minimum monthly payments, at which time lenders will also suspend collections calls if they have not previously done so and begin treating the loan as current.[162] Lenders typically close credit card accounts that are enrolled in a DMP and may consider consumers' taking out of new credit to be grounds for cancellation, although consumers are sometimes allowed to retain one credit card so long as they do not revolve balances and the degree of monitoring and enforcement appear to vary in practice.[163]

In addition to providing general budgeting advice and educating consumers about the broader range of debt resolution options as in Appendix A, nonprofit counseling agencies (or in a few cases, for-profit entities) act as DMP administrators by assessing eligibility, facilitating contract finalization, and forwarding portions of consumers' monthly payments to individual lenders. Distressed borrowers frequently find counseling agencies through information on their credit card statements, internet searches, family and friends, or recommendations from a broad range of entities including creditors, counseling agency networks, community-based organizations, and government programs.[164] While some agencies pay for advertising, they have substantially fewer resources than for-profit debt settlement companies (See Section 2.2.4) and are further restricted by state laws in some locations.[165] As a result, counseling agencies aim to generate as many "organic" connections as possible through engagement with local organizations and governments.

Credit counselors typically start intake processes by going over a consumer's household finances to provide general budgeting analyses and recommendations, such as evaluating potential reductions across a broad range of expense categories and applying for various assistance programs. They then evaluate the consumer's level of hardship and eligibility for enrolling in a DMP by assessing whether the consumer's income is sufficient to cover the expected cost of DMP payments authorized by their individual lenders after accounting for monthly expenses and a small additional amount for discretionary expenses or savings.[166] Accordingly, counselors typically collect relatively

BOX 5 COUNSELING AGENCIES' TECHNOLOGY USE FOR DATA INTAKE AND COUNSELING DELIVERY

Because of budget constraints, nonprofit credit counseling agencies' use of data and technology tends to lag that of for-profit actors. While large national counseling agencies operate more sophisticated platforms for interacting with consumers and gathering and analyzing data, smaller local agencies tend to rely on older, less adaptable systems. For example, some agencies' client management systems do not provide two-way texting capability or accept data feeds from application programming interfaces (APIs), which are commonly used for information transfers by a broad range of other financial institutions.[167]

The ability to use phone and video channels for counseling had spread widely even prior to the pandemic, although different agencies place different degrees of emphasis on particular communications channels and state and federal requirements may mandate in-person counseling in certain circumstances.[168] While use of video counseling has increased somewhat during the pandemic, many agencies report that most of their clients prefer phone channels, perhaps because they find discussing their personal finances emotionally draining.

Counseling agencies report different experiences in using digital platforms compared to oral conversations to collect consumers' budgeting data. While online web forms allow borrowers to input their financial data asynchronously and at their own pace, some counseling agencies report the information is often incomplete or inaccurate and ultimately requires additional verification by a credit counselor. At the same time, some agencies report that consumers may rely on memory when providing financial information during counseling sessions, which can also require further follow-up and validation. Agencies broadly report that younger consumers often prefer to enter information upfront and only speak to a counselor near the end of the process, while older clients often tend to prefer to speak to a counselor before sharing sensitive information.

Counseling agencies also vary in their reliance on technology to deliver educational content and interact with clients. Several agencies have experimented with chatbots but report mixed results. Most also use texts and email for appointment and payment reminders, responding to individual inquiries, and delivering messages to encourage DMP enrollees stay engaged and current on their payments, although the lack of two-way messaging limits some agencies' ability to use such channels to their full effect.

Agencies also vary as to their analytics capability. For instance, while one group of agencies is collaborating to develop machine learning models to predict which consumers are most likely to drop out of DMP programs for purposes of targeting encouraging messaging and additional support, other agencies struggle to secure resources for program analysis and improvement. Although agencies gather detailed budgeting information from clients, they have fewer analytical and model-building resources than other market actors. Agencies also have limited resources for monitoring consumers over time, and often may not realize if a second hardship has occurred unless and until the client reaches out or misses a DMP payment.

detailed information about household income and size, debt obligations, and monthly bills. Counseling agencies vary as to what communications channels and technologies they use in intake and counseling processes (See Box 5).

In addition to assessing consumers' eligibility for DMP enrollment, counseling agencies may help them prepare to negotiate directly with their lenders and/or provide bankruptcy counseling.[169] When consumers decide they want to enroll in a DMP, counselors must then reach out to individual creditors to facilitate finalizing agreements. That process can take substantial time depending on the individual lenders' process requirements and systems, which may also complicate enrollments.[170]

Consumers' DMP payments cover both the amounts due to individual lenders and a portion of plan administration expenses, with other expenses covered by voluntary "fair share" payments or grants from lenders (See Section 3.1.2). Consumer fees may include a one-time enrollment charge of $75 or less and/or a monthly fee of $50 or less, although some states set specific caps and agencies are conscious that higher fees tend to discourage enrollments. Federal tax law both limits the percentage of funds that agencies can receive from fair share payments and requires agencies' fee policies to allow for waivers where individual consumers are unable to pay.[171]

Most lenders use a particular credit reporting code to note that the consumer is paying pursuant to a DMP agreement, although they are not specifically required to do so under existing regulations or industry data standards and the code disappears from consumers' reports once the lender stops reporting it. The flag for debt management plan enrollment is not treated as a derogatory item by credit scoring models, although distressed borrowers may continue to experience credit score declines in the first months after enrollment, for instance if closing accounts causes changes to their credit utilization ratios.[172]

DMPs are typically limited to no more than 60 months in accordance with bank regulatory guidance and some state laws (See Section 3.1.2 and Section 2.2.2), but interviews suggest that most consumers complete DMPs in about 48 months and for some agencies within 36 months. Several factors can contribute to early payoffs, including tying off smaller balance accounts to concentrate on larger ones, using tax refunds or bonuses, general improvements in the consumer's underlying finances, and extra efforts to reduce expenses. However, tracking program completion can be complicated because some consumers choose to self-administer the final payments with their creditors, either because they do not want to continue paying monthly fees or because they are concerned that having DMP-related flags on their credit reports could affect their ability to seek new loans.

2.2.3.2 Overview of Research

Public sources on the number and size of DMPs are limited, and those sources that rely on credit bureau records are undercounts since not all lenders flag accounts enrolled in a DMP. A Federal Reserve Bank of Philadelphia discussion paper reported that 1.6 million consumers had enrolled 3.3 million accounts in DMPs as of May 2011,[173] while the CFPB study of 2007-2019 credit bureau records discussed in Section 2.2.2 reported that about 1.5 million accounts were reported as enrolled in DMPs from 2007 to 2009, followed by several years of decline as the economy recovered from the 2008 financial crisis. After 2012, the CFPB reported that the number of accounts enrolled in DMPs remained roughly steady at about 500,000 annually, even after delinquencies on unsecured credit started to rise.[174] The National Foundation for Credit Counseling (NFCC), whose members comprise about two-thirds of the sector, reports that its members administered roughly 200,000 DMPs annually in the years leading up to the pandemic.[175]

A handful of academic studies have analyzed DMP enrollments and outcomes over the past two decades. The research confirms that a substantial number of counseled consumers are not deemed eligible for DMP enrollment and that substantial numbers of eligible consumers choose not to participate. Multi-agency studies find that roughly a quarter to a third of counseled consumers enroll in a DMP, which is generally consistent with the estimates provided by interviewees.[176] DMP participants tend to be in somewhat better financial shape than counseled consumers who do not enroll as measured by derogatory items on their credit reports and by self-reported income and assets. DMP participation also tends to be higher among counseled consumers who are married or living with a partner and have at least some college education.[177]

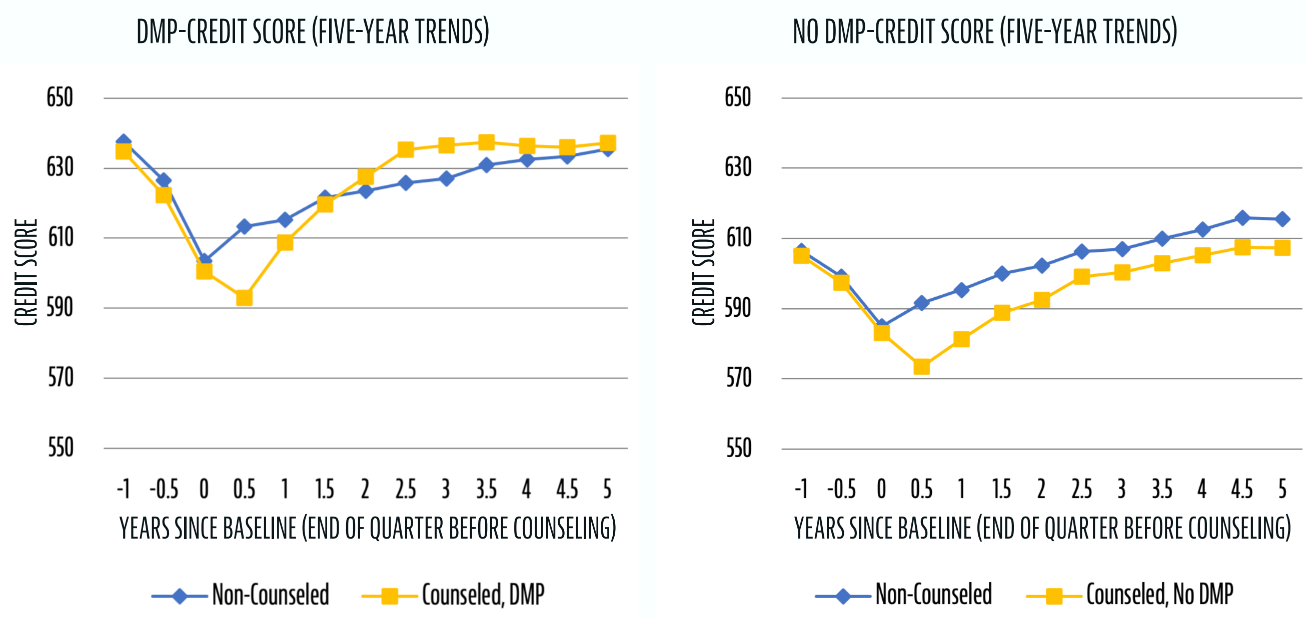
DMP participants tend to experience more positive financial outcomes over time when compared to counseled consumers who do not enroll in the programs. For example, a study of consumers counseled by five agencies in fall 2007 found that by August 2010, DMP participants experienced larger credit score gains (by an average of 20 points) and were substantially less likely to have filed for bankruptcy (16 versus 28 percent) than consumers who only received counseling. Results were similar when comparing DMP participants to consumers who met the eligibility requirements but did not enroll.[178]

A more recent study of consumers counseled by eleven NFCC members between 2013 and 2016 performed a more complicated analysis that not only compared DMP enrollees to consumers who only received counseling, but also benchmarked the two groups against individual consumers who had otherwise similar credit profiles in the year prior to the counseling date but had not participated in counseling or DMPs.[179] Although there were limitations to the matching data and some indications that the consumers who sought counseling may have been more distressed than the consumers in the comparison groups,[180] the analysis found that DMP participants performed better on a number of key metrics compared to the other cohorts.

For example, the study found that DMP participants made statistically significant reductions in total debt and particularly credit card debt over five years relative to the otherwise similar non-counseled consumers. While consumers who only received counseling also reduced their total and credit card debts more than their comparison group, an analysis of tradeline level data indicates that the reductions were largely due to charge offs, bankruptcies, and settlements, whereas the DMP participants were more likely to reduce their debts through paying off balances. The larger debt payoffs in turn appear to have helped DMP participants make faster improvements in their credit scores compared to the other groups by rebounding within 2.5 years after counseling to the same level that they had been at one year prior to seeking assistance.[181]

Some older studies have explored the extent to which various borrower characteristics, the size of concessions, and program length predict DMP repayment levels or other positive outcomes for DMP participants. Not surprisingly, they generally find that repayment levels are higher for DMP participants with stronger finances at the time of initial counseling.[182] They also suggest that repayment levels are higher where DMP enrollees are receiving larger reductions in interest rates relative to the rates on their unsecured credit prior to DMP enrollment, and lower where the composite interest rate on debts enrolled in the DMP is relatively high.[183] One study also suggests that the length of the payment plan can be an important factor in plan outcomes, in addition to the amount of concessions (See Box 6). One study that analyzed consumers' answers to counselor questions about the source of their distress found that repayment levels were slightly higher among consumers who reported habitual or cumulative problems rather than a one-time event such as job loss or divorce.[184]

FIGURE 5 DMP PARTICIPANT FIVE-YEAR TRENDS



Source: Adrienne DiTommaso & Stephanie Moulton, Credit Counseling and Long-Term Credit Outcomes: Evidence from the National Foundation for Credit Counseling's Sharpen Your Financial Focus Program (2022).

BOX 6 STUDY OF REPAYMENT PLAN STRUCTURES AND TIMELINES

One study of consumers who sought counseling in 2005-2006 explored the effect of providing deeper concessions to DMP participants through mechanisms that changed the length of the repayment plans.[185] At that time, most lenders did not offer different tiers of concessions depending on an individual consumer's circumstances. As part of the project, however, eleven credit card issuers agreed to offer more generous terms by (1) reducing monthly payments in return for a longer plan length; (2) effectively reducing interest rates beyond baseline levels by forgiving the last several months of payments; or (3) offering a combination of both concessions. About half of counseled consumers were randomly assigned to a control group that received only standard concessions,[186] while the individual consumers in the treatment group received a wide variety of terms depending on the amount of debt they held with particular lenders.[187]

The study used multivariate analyses to isolate and compare the effects of the most generous interest rate write-downs with the most generous payment reductions.[188] Compared to the control group's means, the maximum interest rate write-down increased the probability of starting and completing the repayment plans by 3.9 percentage points and 2.7 percentage points, respectively, while decreasing the likelihood of filing for bankruptcy within five years by 3 percentage points. However, the largest payment reductions—which increased the total interest due because of the longer plan lengths—did not produce statistically significant effects on enrollment and completion rates relative to the control group's means and were associated with a 2.3 percentage point higher rate of bankruptcy filings. Additional analyses suggest that the monthly payment reductions had some positive initial impacts, but that those effects were offset because extending the repayment plan length increased risks that the participants experience a second financial hardship before the end of the plan.[189]

Notably, some aspects of the pilot program do not appear to match modern practice. For example, the counseling agency's screening practices appear to have resulted in only about 7,000 of 85,000 consumers not being offered a DMP,[190] although more recent sources suggest that roughly 50 percent of counseled consumers are not recommended for DMPs today. In addition, many lenders have adopted tiering systems based on financial distress levels since the 2008 financial crisis, and typically implement interest rate reductions when consumers first enroll in DMPs rather than by forgiving payments at the end of the plan. Modern DMPs also do not typically extend beyond 60 months, although a new pilot project is starting to evaluate whether longer payment schedules may help consumers who would otherwise not qualify for DMPs (See Section 6).

2.2.4 Debt Settlement

Debt settlement involves for-profit intermediaries that contact lenders to settle consumers' unsecured debts for less than the full balance owed. Debt settlement companies (DSCs) describe themselves as a "private-sector alternative to bankruptcy" that is faster and less expensive than paying off full credit card balances over time.[191] In the three years prior to the pandemic, settled balances and consumer enrollments with DSCs appear to have at least doubled at a time when debt management plan enrollments and bankruptcies were growing only modestly in the face of rising delinquency rates.[192]

Yet despite their increasing popularity, independent data and research about DSC customers and their outcomes is extremely limited. Industry data for consumers who enrolled with large companies before March 2017 indicate that about 60 percent were able to settle at least half of their enrolled accounts within 36 months and that the amount of debt reductions exceeded the primary fees paid to DSCs for their services.[193] However, the cost of DSC services can be substantially higher than other resolution options—in many cases, roughly 25 percent of settled balances—and consumers may experience substantial balance increases and credit score declines soon after enrollment. About one quarter of DSC customers do not settle any loans through the programs, in which case they cannot be charged DSC fees under federal law but may still experience negative secondary effects.

Because of these and other factors as discussed below, debt settlement appears to be both the fastest growing and most controversial debt resolution path available today. Proponents argue that it meets a real need created by gaps in other resolution offerings, that regulatory initiatives and changes in market practices have improved outcomes, and that lenders' historical hostility to DSCs negatively effects participating consumers. Critics argue that DSC' business models and practices continue to raise serious concerns, for example by encouraging consumers to engage in strategic behavior when they can actually afford to repay their debts and by inflicting substantial additional damage on the finances and credit reports of some truly struggling borrowers.

2.2.4.1 Basic Mechanics

DSCs engage in heavy marketing activity through television, radio, and internet channels,[194] and some have historically used credit bureau data to mail offers to "prescreened" consumers despite concerns about the legality of that practice.[195] DSCs generally use digital platforms and call centers to work with consumers rather than in-person consultations.[196] Upon initial contact, consumers are screened for income, debt levels, and other eligibility criteria. Among larger DSCs, consumers may not be accepted for enrollment if they do not have a minimum amount of debt (typically $10,000 to $15,000) and a steady source of income. If consumers do not meet the DSC's criteria or reside in a state where the DSC is not licensed to operate, some DSCs may refer them to bankruptcy lawyers or to nonprofit counseling agencies. Compensation for such referrals is often restricted but remains a point of concern for consumer advocates.[197]

Upon contract signing, DSCs typically advise clients to begin depositing funds into a dedicated account at an insured financial institution for use in eventual settlements. If clients have not already stopped paying their lenders, they generally do so after enrolling with a DSC either based on the company's advice or because they cannot afford to make both payments. While the consumer is saving funds and settlement processes play out over several months, debt balances on remaining loans continue to accrue and additional delinquencies are reported to credit bureaus at least until the point that lenders charge off the accounts.

Historically, DSCs have often acted to sever direct communications between clients and their lenders, for example by advising consumers to switch their contact information to the DSC's address and telephone number or to sign a power of attorney or a cease-and-desist request and instruct lenders to communicate only through the DSC. Some companies report that they have stopped many of these practices and an industry trade organization restricted them with regard to new customers in standards issued in 2021, but interviews suggest variations remain.[198] While stopping calls may be a relief to consumers, it prevents them from receiving direct workout offers from lenders, and some lenders may be more likely to file collection suits when communications are cut off. Several stakeholders expressed concern in interviews that some DSCs are targeting consumers who have not yet become delinquent, even though they are likely to suffer severe credit report damage if they stop paying their bills and may not yet have had any discussions with their lenders about workout options.

DSCs will generally initiate negotiations once the consumer has accrued funds equal to at least 20 percent of a particular debt.[199] DSCs are prohibited by federal law from collecting fees for their services until a client accepts and begins payment on the first settlement (See Section 3.1.3). Settlements can occur more quickly if (1) the consumer and lender are willing to accept an installment settlement paid out over several months; or (2) if the consumer is willing and able to take out a new loan to cover the settlement cost before they have accrued sufficient savings. The industry appears to be moving increasingly toward these models, although both options have potential cost and time tradeoffs for consumers (See Box 7).

Lenders' reactions to their customers' enrollment with DSCs varies depending on their policies and recovery strategies. A few lenders categorically refuse to negotiate with DSCs and may file suit

BOX 7 DEBT SETTLEMENT FINANCING

Loans to finance debt settlements are similar to full-balance debt consolidation loans but may have higher costs if consumers have stopped paying their accounts, since that can substantially reduce their credit scores.

A 2021 report released by an industry trade association representing mostly large DSCs suggests that about 25 percent of debt settlement activity now involves debt settlement financing that is provided by state or federally chartered banks working with DSCs.[200] The loans are not offered until a consumer has been enrolled for at least six months, has demonstrated a history of making steady monthly payments, and has typically already settled one or two debts. The loans are designed to resolve the entire remaining balance, with traunches paid out as each settlement is reached. Interest begins to accrue on each installment after it is paid, and accrued amounts are rolled into the principal when the loan closes upon settlement of the last debt. Loan terms are typically five years. Based on an analysis of $2.4 billion in such loans, the report found that the most common loan size was between $10,000 and $15,000 and that rates were 22 to 25 percent, but did not describe origination fees or annual percentage rates.

DSCs have strong incentives to encourage their clients to take out such loans because quicker settlements may be eligible for deeper concessions by lenders and eliminate the risk that borrowers will be sued on the underlying debts, as well as allowing DSCs to collect fees in conjunction with the settlements. Where DSCs originate the loans through partnerships or are otherwise paid to refer consumers to lenders, they can also become a revenue source in their own right. The 2021 report asserts that the loans can be a strategy for improving consumers' credit scores, but does not provide long-term statistics on scores or repayment performance.[201]

in situations where direct communications are cut off.[202] However, interviews suggest that such policies and practices have become less common as the debt settlement industry has continued to expand, and many lenders believe that it is not practicable to avoid dealing with DSCs in today's market because so many consumers have enrolled in their programs. The situation is also complicated by the fact that lenders may work with debt collectors or sell debt to buyers who may be willing to work with DSCs even if the original lender will not do so.

At the other end of the spectrum, some lenders affirmatively work with third-party vendors or selected DSCs to try to determine whether their customers have enrolled with the companies, believing that it is helpful to change their outreach strategies because the fact that consumers have enrolled with the companies shows that they are trying to manage their debts and intend to pay off some of their balances. Some lenders may seek to be the first in line to receive settlement offers when a particular consumer has accrued sufficient funds for negotiations.

The CFPB's most recent survey of large credit card issuers found that most respondents maintain a policy of not working "directly" with DSCs, but does not distinguish between lenders who simply refer DSC-enrolled accounts to be handled by a third-party collection agency from those that have a categorical policy of refusing to engage with DSCs.[203] Among the issuers that indicated that they were willing to work directly with DSCs, the majority reported that they offer the DSCs the same settlement policies that they make available to consumers who call directly to request a settlement. A minority have settlement rates specific to debt settlement companies that forgive a smaller percentage of the balance owed than the floor settlement rates available in their bilateral workouts.

Upon enrollment with a DSC, the amount of consumers' monthly payments vary depending on their cash flows. In addition to building funds for settlement, the payments are also used to cover administrative costs for the associated account (typically $5 to $10 per month paid to the financial institution) and the DSCs' fees (which may range from 15 to 25 percent of the settled balances, once consumers have accepted and started paying on individual settlements).[204] As with bilateral settlements for less than full balance, consumers will be taxed on the written-off amount if it exceeds $600 unless they can show that they were insolvent, and some credit scoring models will treat the settlements as derogatory items.[205] Similar to debt management plans, consumers may drop out of DSC programs to negotiate directly with remaining lenders.

2.2.4.2 Overview of Research

Research on the volume and outcomes of debt settlement processes is limited. As discussed above in Section 2.2.2, credit reports do not distinguish consumers who have settled a debt through a DSC from consumers who have negotiated individually with their lenders to settle a particular account for less than full balance. They also typically do not reflect a settlement until it is complete, so determining the precise point at which DSC enrollment or negotiations with a particular lender began is not possible from credit report data.

The CFPB's surveys of large credit card issuers provide some window on growth in this market segment. In 2017 and 2018, respondents reported that the dollar amount of pre-charge-off DSC settlements grew by 117 percent and post-charge-off DSC settlements by 104 percent, compared to 16 percent growth in accounts receivable and 12 percent growth in charge offs. Overall, the respondents reported that nearly $2.2 billion in debt was settled through DSCs within the two-year period, of which $1.4 billion was settled post-charge-off.[206] The CFPB's summary of survey results from 2019-2020 does not provide growth rates, but indicates across the issuer respondents as a group, 54 percent of the balances settled pre-charge-off and 44 percent of the balances settled post-charge-off were enrolled with DSCs. Distribution varied widely at the individual issuer level, however, ranging from nine to 60 percent for pre-charge-off debt and from 23 to 62 percent for post-charge-off debt.[207]

Data from the American Fair Credit Council (AFCC), an industry trade group representing mostly large DSCs, also indicate that enrollments are growing rapidly.[208] The most recent report indicates that about 1.6 million consumers enrolled 11.7 million accounts at ten large DSCs between January 2011 and March 2020, with two-thirds of the enrollments occurring in the last three years. The median amount of enrolled debt was $27,500 across seven accounts.[209]

Although the report does not provide detailed statistics or descriptions of eligibility criteria, it states that the participating companies enrolled about 15 percent of consumers screened; in contrast, the 2017 edition based on data from a smaller number of companies stated that they accepted 10 percent.[210] Across the nine-year period, the 2021 report states about 50 percent of the DSC enrollees had already gone delinquent on one or more accounts before they contacted the DSC, while the 2017 edition indicates that 75 percent were already delinquent.[211] The 2021 report indicates that participants' debt levels increase by about 13 to 14 percent within ten months of enrollment due to the accumulation of additional interest and fees, after which balances plateau likely due to charge offs of the underlying accounts.[212]

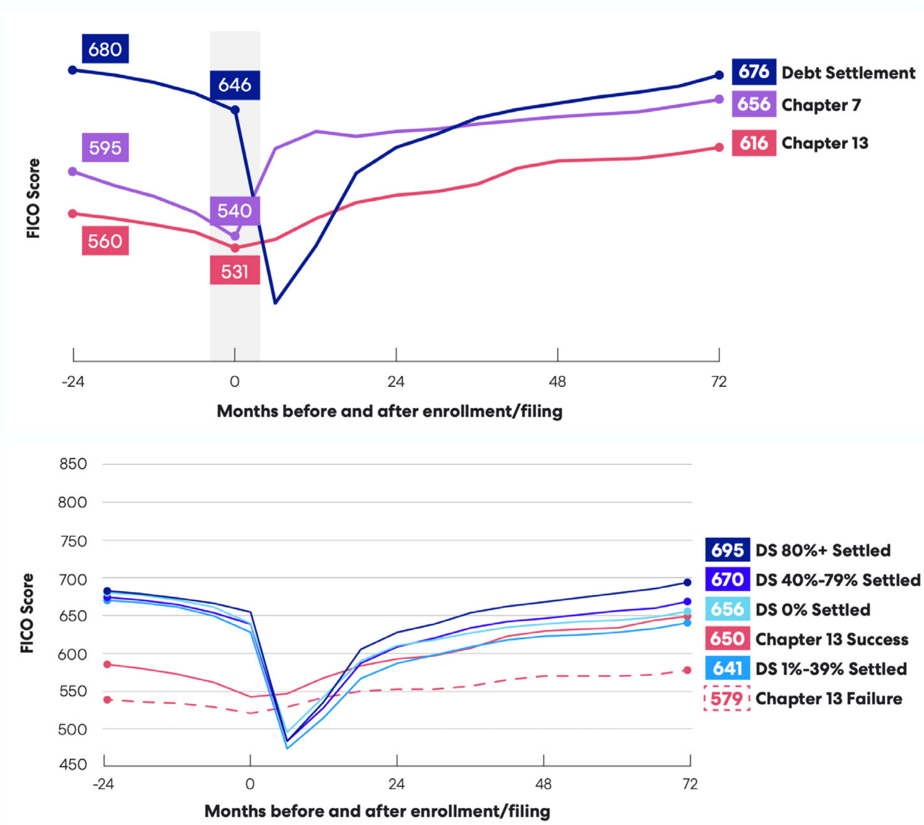
With regard to the frequency and pace of settlement, the study indicates that about 25 percent of the enrollees over the nine-year period had not settled any accounts, while 28 percent had settled one or two accounts, 30 percent had settled three to five accounts, and the remaining 20 percent had settled six or more accounts.[213] Although some interviews suggested that the average time to first settlement has dropped in recent years as lender practices have changed, data over the entire time period indicates that enrollees' first settlements occurred on average about 5.5 months after enrollment and second settlements after about 8.5 months. A second analysis of DSC clients with at least 36 months of account history similarly found that about 25 percent of consumers did not settle any accounts, while about 60 percent settled at least half of their enrolled debt with the first settlement occurring about four to five months after enrollment.[214]

For settlements on which information about the payment schedule was available, the AFCC report states that 42 percent of settlements were for lump sums while 58 percent were structured as installment settlements, but did not provide statistics with regard to their length.[215] The report indicates that about 25 percent of debt settlement activity was financed through loans which typically have five-year terms (See Box 7).

The analysis of the full data set over nine years indicates that the typical settlement amount is approximately 50 percent of the balance owed at settlement, but that fees to the DSC reduce the total savings to roughly 30 percent of the balance owed.[216] Similarly, the study of consumers with at least 36 months of history found that those consumers received an average write-down of 32 percent on settled accounts after accounting for the main DSC fees, but not account administration fees or potential tax consequences.[217]

In addition to the AFCC data, the nation's largest DSC has released data on its customers' credit scores and other outcomes, in some cases benchmarked against bankruptcy filers.[218] The most recent report by Freedom Financial tracks all clients enrolled between March 2014 and February 2015 against a representative sample of consumers who filed for bankruptcy in the same period, beginning two years before enrollment/filing and ending six years after. The debt settlement clients' median scores at enrollment/filing were at least 100 points higher than those of the consumers who filed for Chapter 7 or Chapter 13 bankruptcy, but declined by 160 points within six months of enrollment. They overtook the bankruptcy cohorts' medians after an additional two years and were 20 to 60 points higher at the six-year mark.[219]

FIGURE 6 FICO SCORE OVER TIME: BANKRUPTCY FILERS AND DEBT SETTLEMENT CLIENTS



Source: Frederick Huynh, Debt Settlement and Bankruptcy: A Comparison of Credit Scores, Freedom Debt Relief (2022)

When disaggregated based on the amount of debt settled, the analysis finds that clients who settled at least 80 percent of their enrolled debts started with slightly higher scores and ended with the highest medians, while consumers who settled between one and 39 percent of their enrolled debts started with the lowest scores and ended with the lowest medians. Consumers who withdrew from the program without settling debts fell in between, which the report attributes in part to self-selection based on exit surveys. The analysis also highlights low credit scores among consumers who filed for Chapter 13 bankruptcy but failed to obtain discharge (See Section 2.2.5).[220]

2.2.5 Bankruptcy

Bankruptcy is a federal court-supervised process for consumers who are insolvent to discharge multiple debts, get protection from wage garnishment and other collection efforts, and preserve at least some property so that they can begin to reset their finances. It also provides a structure for lenders and debtholders to work out their competing claims. But while this structure may help balance these interests and can address more types of debts than just unsecured loans, it is often portrayed as a last resort that carries substantial stigma. Its practical downsides for consumers can include the length and expense of the process, the fact that some consumers drop out before obtaining a discharge of their debts, and downstream effects on future finances including credit limits and pricing. Many lenders also prefer other debt resolution options in hopes of getting higher recoveries.

Consumer bankruptcies are typically handled under Chapter 7 or Chapter 13 of the U.S. Bankruptcy Code, depending on the state of the consumer's finances.[221] About two-thirds of filings occur under Chapter 7, which is only available to consumers below certain income levels. About 95 percent of Chapter 7 filers obtain discharge of their debts, typically in less than six months, but they must surrender any assets that exceed exemption levels to be applied toward those obligations. In contrast, Chapter 13 is used by consumers who have more income or who want to protect particular assets from being sold off and requires filers to make payments for up to five years before discharge. However, as discussed further below, as many as two-thirds of Chapter 13 filers do not actually obtain discharge of their debts at the end of the process, and a growing body of research has also found significant racial disparities in bankruptcy filings and outcomes.

2.2.5.1 Basic Mechanics

A consumer initiates the bankruptcy process by completing a pre-filing credit counseling session as mandated by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005.[222] This pre-filing counseling informs potential filers of the financial and other consequences of bankruptcy and was designed in part to reduce consumer filings.[223] After this counseling, a consumer who wants to proceed must file a petition with a bankruptcy court which includes extensive information about assets, liabilities and contractual obligations, income, expenses, and past tax returns.[224]

Filers pay bankruptcy case filing fees, administrative fees, and trustee surcharges, which may be paid in installments or waived entirely with court permission for filers under extreme financial hardship. In addition, filers also typically pay attorneys' fees. Although costs vary across the country, some sources suggest that the filing fees and attorneys' fees average about $1,800 for Chapter 7 and $3,300 for Chapter 13.[225] As described further below, differences in the timing of fees between Chapter 7 and Chapter 13 filings may influence which option consumers pick.

Filers are assigned to a trustee and a bankruptcy judge within a few days of the initial filing. Trustees review debtors' petitions and documentation and administer bankruptcy estates, among other responsibilities.

Mechanics of Chapter 7

In Chapter 7 filings (often referred to as liquidations), consumers can discharge most unsecured debt and get protection from wage garnishment and other collection efforts, but must surrender any assets that exceed exemption limits to be applied toward the debts. Chapter 7 bankruptcy protection is only available to consumers who meet means tests, which hinge in part on whether their incomes fall below their state's median family income.[226] Consumers who exceed state thresholds must be evaluated to determine if they have enough disposable income for a repayment plan under Chapter 13 bankruptcy, in which case their Chapter 7 filing will be dismissed and the case can be converted to a Chapter 13 bankruptcy filing.

Between 60 and 70 percent of personal filings occur under Chapter 7, depending in part on economic conditions.[227] Most filers have such low incomes that their assets are exempt from surrender.[228] While exemption thresholds vary from state to state, they are generally designed to protect consumers' clothing, furniture, and professional "tools of the trade." The exemptions also protect a certain amount of equity in vehicles and owner-occupied homes, but only up to state limits. Bankruptcy trustees typically sell assets that exceed the exemption thresholds so that the proceeds can be used to pay creditors.[229] Thus, consumers who are particularly concerned about protecting their homes or cars may find Chapter 13 more appealing.[230]

Chapter 7 bankruptcy filers typically receive a discharge of their debts within about six months of filing their petitions. Before formal discharge is granted, they must complete a second financial education course. Chapter 7 filers cannot refile for another Chapter 7 bankruptcy for eight years, and a bankruptcy flag remains on their credit report for 10 years after filing.[231]

Fees paid to trustees and attorneys are substantially less for Chapter 7 than for Chapter 13 filings, in part because the processes are shorter and simpler. However, they are typically paid up front because the proceedings are relatively quick. As discussed further below, this may operate as a barrier to Chapter 7 filings for some consumers.[232]

Mechanics of Chapter 13

In a Chapter 13 filing (often referred to as a wage earner's plan), consumers can discharge most unsecured debts, get protection from wage garnishment and other collection efforts, and keep most or all assets, but must generally pay all disposable income to reduce debts over three to five years. In effect, Chapter 13 gives filers a chance to restructure certain secured debts and reduce payments to unsecured creditors so that they can prioritize making payments to remaining secured creditors in hopes of bringing those accounts current to avoid foreclosure or repossession.[233] Protecting one's home is frequently cited as a primary motivation by individuals filing for Chapter 13 bankruptcy, but it can also be an appealing option to consumers who are trying to protect their cars and/or drivers licenses in the face of auto loan delinquencies, parking tickets, and other government fines that are not dischargeable under Chapter 7.[234]

Chapter 13 filers must have "regular" income and debts below certain statutory thresholds.[235] After initial counseling, filers must submit a bankruptcy petition, required documentation, and a proposed repayment plan that meet certain thresholds. Individuals whose income falls below their state's median income are generally placed on a three-year repayment plan, after which their remaining debts will be discharged; higher-income individuals are generally placed on five-year plans, although filers may qualify for a shorter plan period if they commit to pay unsecured creditors in full or if the parties otherwise agree.[236] After bankruptcy trustees have convened the parties and consumers have made any amendments to their plans, a bankruptcy judge must approve the final versions. Judges will terminate cases if the plans do not comply with the Bankruptcy Code or if consumers are highly unlikely to be able to complete the repayment plan based on projected income and expenses.[237] Bankruptcy judges or bankruptcy filers can potentially convert the cases to Chapter 7 if the consumer meets certain qualifications.[238]

Once the repayment plan is approved, consumers make biweekly or monthly repayments to the trustees, who distribute payments to creditors in order of priority.[239] During this period, filers are generally required to live on limited budgets and generally cannot take out new credit without the trustee's approval.[240] It is not uncommon for Chapter 13 filers to miss one or more scheduled repayments,[241] after which bankruptcy judges offer forbearance, allow consumers to file a plan modification (which requires another round of approval), or dismiss cases entirely. If Chapter 13 filers' housing and transportation costs are so expensive relative to their income and other expenses that they cannot afford their loan payments, creditors may also move to file a motion to repossess or foreclose on the collateral. Faced with this situation, many filers will give up on their bankruptcy cases entirely, which ultimately leads to a dismissal without any debt discharge.[242]

Chapter 13 discharges cover a broader range of debts than in Chapter 7 bankruptcy.[243] Again, consumers must complete a debtor education course prior to discharge. Chapter 13 bankruptcy filers must wait two years after a previous Chapter 13 discharge to file again, and a bankruptcy flag remains on their credit report for seven years after filing.[244]

Chapter 13 bankruptcy is more expensive for filers due to the length and complexity of the proceedings, and fees paid to trustees and attorneys can be at least three times as high as in Chapter 7 bankruptcy.[245] Chapter 13 filers start making payments into their repayment plans within one month of submitting them (even if they have not been confirmed), which include attorneys' fees that are given priority status relative to other creditors. However, filers do not have to pay the attorneys' fees up front, which may make it a more appealing option for some consumers than Chapter 7.[246]

2.2.5.2 Overview of Research

Academic researchers have focused substantially more attention on bankruptcy than any of the other debt resolution channels discussed in this report, although there are still important factual questions about the consumers who file for bankruptcy and their financial outcomes over time. This section provides an overview of major themes and findings in the available literature.

Unsurprisingly, individuals who file for bankruptcy are in more financial distress relative to other consumers. One examination of filings in four bankruptcy courts between 2001 and 2018 found that the average bankruptcy petitioner files 22.3 months after first being 90 days past due on a debt, while the median bankruptcy petitioner files 11.3 months after first being 90 days past due.[247] Studies comparing Chapter 13 filers to typical credit users find that filers are more likely to have suffered from an adverse financial event (such as a civil judgment or repossession), have higher amounts of unsecured and secured debt, and have lower credit scores.[248] Various studies indicate that, relative to the general population, bankruptcy filers are less likely to be immigrants and more likely to be middle-income, divorced, Black, veterans, to have a high school diploma or some college education, to be employed, and to be older.[249]

By the time that consumers file for Chapter 7 or Chapter 13, they usually have already experienced multiple derogatory items on their credit reports, credit score declines, reductions in available credit limits and account closures, and credit application rejections because of the degree of their financial distress. Similar to Figure 6 in Section 2.2.4, research shows that credit scores generally improve slightly after filing and substantially more upon obtaining discharge. Outcomes may be substantially more positive than for similar consumers who not seek and obtain discharge.[250] However, filers are still likely to face substantially higher prices and lower credit limits than before filing and private employers and landlords may also treat bankruptcy filers differently than other applicants (See Section 2.1.3).

Studies examining Chapter 7 bankruptcy outcomes suggest that obtaining discharge is associated with subsequent increases in access to secured lending, homeownership, and small business formation. For instance, one analysis of bankruptcy cases from 2006 to 2009 examined outcomes of filers whose incomes were just above or below the threshold to qualify for Chapter 7 proceedings.[251] Within the first three years after filing, it found that Chapter 7 filers who obtained discharge were 9.8 percentage points more likely to obtain secured loans, 11.4 percentage points more likely to obtain mortgages, about 50 percentage points less likely to experience foreclosures, and 5 percentage points more likely to start a business than consumers whose incomes required that they file under Chapter 13 or whose Chapter 7 filings were dismissed. With regard to unsecured credit, existing lenders substantially cut Chapter 7 filers' credit limits upon filing. While filers often obtain new credit cards soon after filing and discharge, their overall credit limits remain far below pre-filing levels for at least six quarters after filing.[252] Prices also increase substantially for consumers with prior bankruptcy filings, although those effects are not documented as extensively in academic literature because pricing information is not provided in credit reports.

Outcomes for Chapter 13 filers are further complicated by the fact that filing and discharge are separated by three to five years. In the interim period, some research suggests that Chapter 13 filers are able to keep somewhat more of their original credit accounts active and have slightly higher total credit limits than for Chapter 7 filers, but that they are 74 percent less likely than Chapter 7 filers to receive new credit cards.[253] While paying on their plans, Chapter 13 filers have better interim outcomes on such metrics as delinquency, creditor charge-offs, collections, foreclosure, civil judgments, liens, and repossessions than consumers who are dismissed from the programs, but studies suggest that these differences may be largely driven by deterioration in the dismissed filers' financial conditions absent the bankruptcy protections rather than improvements by the successful filers.[254] Chapter 13 filers who do obtain discharge experience more substantial improvements in credit scores, access to new credit, and other metrics upon reaching that milestone.[255]

Under both chapters, consumers who have obtained discharge typically experience another boost in credit scores when the bankruptcy flags are removed from their credit reports—at ten years post-filing for Chapter 7 filers and seven years post-filing for Chapter 13 filers—but may still face lingering effects. One study of Chapter 7 filers found that credit scores increased by 14 points in the first year after the flags were removed and an additional 17 points in later time periods.[256] However, this analysis also found that this increase in credit scores did not translate into comparable increases in credit card limits and balances. Another study of Chapter 7 filers' credit reports found that credit scores increased significantly when bankruptcy flags were removed across most credit score bands, and the number of bank credit cards and size of line limits increased, especially for filers with relatively high credit scores.[257] However, filers who took on increased debt experienced higher delinquencies over time than their scores prior to the flag removal would have suggested, dissipating the earlier score boost within a year.

Another analysis of data from the Survey of Consumer Finances found that households that reported having filed for bankruptcy more than nine years earlier had a similar or higher likelihood of having unsecured revolving credit, a home mortgage, or a vehicle loan than non-filers and did not pay higher rates than non-filers for at least some credit products.[258] However, filers also tended to have accumulated less wealth, carried higher credit balances, and were more likely to fall behind in their debt repayment schedules than non-filers.

Beyond these general outcomes, there are two somewhat overlapping groups for which bankruptcy outcomes raise specific concerns. The first is the approximately two-thirds of Chapter 13 filers who do not actually obtain discharge. The second is Black filers, whom research suggests are both disproportionately likely to file for Chapter 13 and experience negative outcomes under both chapters.

As to the first group, multiple studies have found that between half and two-thirds of Chapter 13 filers do not obtain discharge of their debts.[259] There is little research focusing on consumer outcomes for filers whose cases are dismissed, primarily for failure to make the required payments over time. During the time that they are enrolled in Chapter 13, the filers generally benefit from protection from debt collection and wage garnishment and may be able to cure defaults on home or auto loans to stave off foreclosure or repossession. But the requirement to use all disposable income to reduce their debts may leave filers with few options in the event they experience a secondary shock. Upon dropping out of the plans, collections, garnishment, foreclosure, and repossession activities often quickly resume on any remaining unpaid debt, plus interest that has accrued while the filers were in Chapter 13.[260] The percentage of Chapter 13 debtors with previous bankruptcy filings is about 38 percent, compared with only 7 percent for Chapter 7 filers.[261]

Two studies focusing on relatively small or narrow geographic samples find some evidence that a subset of Chapter 13 filers may be using the process to catch up on their home loans but then abandoning it before discharge.[262] However, evidence also suggests that this strategy does not work for many homeowners, and that those who have high housing costs overall are less likely to save their homes or stabilize their finances through Chapter 13.[263] For instance, one study based on more than 300 interviews of Chapter 13 filers who failed to receive a discharge found that about 90 percent of homeowner respondents cited keeping their house as a primary goal. Although about 20 to 25 percent agreed with statements that they had found a better solution or accomplished their goals in filing for bankruptcy, about 20 percent had lost their homes, 28 percent of remaining homeowners were facing imminent foreclosure, and an additional 32 percent of remaining homeowners were at least somewhat delinquent.[264]

Several studies have probed potential explanations for why Chapter 13 dropout rates are so high. Some point to the fact that the all disposable income approach does not account for subsequent income and expense shocks.[265] Others suggest that particularly fragile consumers may be filing Chapter 13 petitions because they are unable to pay upfront attorneys' fees and/or are trying to protect their licenses and cars to preserve their ability to commute to work.[266] Others find evidence that attorney and trustee behaviors may exacerbate strains on the most vulnerable Chapter 13 filers.[267]

Numerous studies have also highlighted negative outcomes for Black bankruptcy filers, suggesting that the percentage of Black consumers who file for Chapter 13 bankruptcy is more than twice as high as members of other racial or ethnic groups, are less likely to obtain discharge through Chapter 13 bankruptcy, and may have worse outcomes in Chapter 7 as well.[268]

Several studies suggest that differences in the behavior of lawyers and trustees may both contribute to these patterns.[269] Two studies also suggest that local enforcement policies concerning traffic and parking tickets may influence racial disparities as Black consumers try to protect their licenses and cars in the face of longer commutes. The studies found that proportion of filers who were Black was far higher among consumers who entered Chapter 13 to protect their licenses and cars, and that such fillers are more likely to exit proceedings without discharging their debts regardless of race. Similar patterns were found Cook County, Illinois, Atlanta, and Memphis.[270]

3. MARKET AND REGULATORY EVOLUTION OVER THE LAST TWO DECADES

The regulatory structures for both unsecured credit and the debt resolution options summarized in Section 2 evolved substantially between 2005 and 2010, largely in response to policy concerns that had arisen prior to the 2008 financial crisis. While some initiatives were not completed until after the Great Recession, federal policymakers' primary focus shifted to mortgage markets in connection with the financial crisis and later to the build-up in student debt. Although markets for general unsecured credit and related debt resolution options continued to evolve over the 2010s, particularly in response to data and technology advances, there was relatively little regulatory or policy activity focusing on workout options.

3.1 Increasing Attention to Unsecured Credit and Debt Resolution Channels

By the early 2000s, general purpose credit cards had overtaken installment loans as the predominant source of general unsecured credit after two decades of rapid growth, particularly among lower-income households.[271] The percentage of households with such cards reached 71 percent by 2004 (up from about 40 percent in the early 1980s), and credit card debt per household had increased to 20 percent of median family income (up from 5 percent in 1985).[272] Widespread promotional offers of zero percent annual percentage rates further encouraged borrowing through successive transfers to new cards, although complaints about aggressive pricing practices in other contexts also increased.[273] Issuers also began reducing the minimum payments required on credit cards from about 5 percent of balances plus interest and fees to about 1 percent of balances plus interest and fees as a way to encourage revolving balances and make up for lost revenue.[274]

As usage patterns shifted, there were signs that some households were struggling with increasing debt burdens. Credit card charge offs and bankruptcy filings both began to rise in the mid-1980s, with increases not just after the 1990-91 and 2001 recessions, but also during periods in which income and employment were relatively strong. Although comprehensive numbers on consumer enrollments are not available, the number of credit counseling agencies and debt settlement companies also increased substantially as discussed below. By 2004, bankruptcies had increased fivefold over 25 years, and more U.S. adults were filing for bankruptcy annually than were graduating from college, getting divorced, or being diagnosed with cancer.[275] Different stakeholders attributed the increase in filings to a range of factors, including the growing reliance on revolving debt, broader changes in income and savings rates that made consumers more vulnerable to shocks, shifts in cultural norms, and flaws in bankruptcy law.[276]

Activity by Congress, federal regulators, and state policymakers began to increase in the mid-2000s as market developments focused greater attention on various debt resolution channels. Federal regulators also began updating credit card regulations to address evolutions in that market over the previous two decades just as mortgage delinquencies started to rise in 2007.

3.1.1 Bankruptcy Reform

As noted above, some critics argued that the surge in bankruptcy filings was due in part to features in the underlying law, such as relatively low filing costs, variations in asset protections at the state level, and provisions that they argued allowed high-income borrowers to abuse the system.[277] In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) to address many of these complaints.[278] For example, BAPCPA imposed the means test for Chapter 7 and required that Chapter 13 filers generally pay all disposable income to unsecured creditors for up to five years.[279] The Act also extended the amount of time before a filer could obtain a second discharge in debt, for example by increasing the time between successive Chapter 7 discharges from six to eight years.[280] It also further heightened barriers to discharging most types of student loans.[281]

In addition to these substantive requirements, the law increased filing fees and other costs, for instance through heightened financial documentation requirements.[282] BAPCPA also required that individuals obtain credit counseling from an approved provider within 180 days prior to filing for Chapter 7 or Chapter 13 bankruptcy and complete a personal financial management course prior to the discharge of their debts.[283] Some nonprofit counseling agencies began providing this counseling (See Section 2.2.3), although they report that it later migrated over time to specialized online providers.

Personal bankruptcies jumped ahead of BAPCPA's October 2005 effective date and then dropped substantially, as annual numbers went from 1.6 million in 2004, to 2 million in 2005, to 600,000 in 2006. The proportion of Chapter 13 bankruptcy filings increased from 20 percent in 2005 to around 40 percent in 2006 and 2007.[284] Although annual filings across both chapters increased during the 2008 financial crisis and remained above one million through 2013, BAPCPA critics argue that it substantially worsened options for the most vulnerable borrowers through heightened fees and other provisions. Statistics on the low discharge rates and racial disparities for Chapter 13 filings remain a central focus in this ongoing debate (See Section 2.2.5).

3.1.2 Credit Counseling Regulation

Federal policymakers also turned increasing attention to the administration of debt management plans in the early 2000s in response to concerns that traditional local nonprofits were being crowded out by a group of what were effectively for-profit entities that were creating poor outcomes for both consumers and lenders. These concerns ultimately culminated in the tightening of federal tax requirements in 2006, the adoption or amendment of various state laws, and market changes in funding and programs offered by counseling agencies.

Consumer advocates first began raising concerns about shifts in the consumer counseling industry early in the decade, questioning whether some new entrants that had been attracted by increasing consumer enrollments were effectively operating as for-profit businesses. The number of agencies had increased substantially between the mid-1990s and 2002, from about 200 to at least 1,000.[285] Advocates raised concerns that many new entrants failed to offer face-to-face interaction with consumers, tended to focus exclusively on providing debt management plans rather than broader counseling services, relied on aggressive marketing tactics, selected only some unsecured debt for DMPs, charged relatively high fees, and maintained close connections to related for-profit lenders and payment processing centers.[286]

Although some states regulated counseling agencies, advocates argued that existing regimes relied too heavily on nonprofit status to ensure quality. The most detailed regimes adopted limits on consumer fees, required written contracts, addressed the handling of consumer funds, and required agencies to post bonds. However, advocates argued that the state laws did not always address emerging practices, were underenforced, and contained too many loopholes to be effective. Some states strengthened their requirements in response to such criticisms, for instance by requiring that debt management plans not last more than a specified number of months.[287]

In 2006, Congress responded by tightening tax exemption standards for counseling agencies, mandating that they provide "meaningful educational services" and meet other IRS standards to maintain their tax-exempt status.[288] The IRS also issued guidance and a core analysis tool (CAT) and launched an audit and examination program for counseling agencies.[289] To maintain their 501(c)(3) status, agencies were required (1) to provide tailored services that meet consumers' specific circumstances and needs (e.g., by incorporating a detailed review of clients' budgets); (2) to provide separate services for improving consumers' credit records, credit histories, or credit ratings only as necessary for the above counseling services, but not charge clients separately for such services; and (3) not to extend loans to counseled clients or negotiate for such loans on clients' behalf. In addition, tax-exempt agencies must provide services to borrowers regardless of their ability to pay or unwillingness to enroll in a DMP. The rules also capped the percentage of revenue that agencies could receive from lenders for administering DMP programs to 50 percent in order to push them to diversify their counseling activities.[290] The IRS subsequently revoked the nonprofit status of agencies representing more than half of the industry's revenue.[291]

Other market and technology changes were also spurring evolution among counseling agencies. As noted in Section 2.2.3, agencies have historically received "fair share" payments from creditors to cover some of the costs of administering DMPs, although the payments are voluntary and may be reduced at any time at lenders' discretion. In the 1990s, the ratios were as high as 12 to 15 percent of enrolled balances and made up as much as two-thirds of agencies' total revenues, which subsidized a wide range of other counseling programs.[292] But by 2010, fair share payments had dropped to an average of about 5 percent due to several factors including lenders' increasing emphasis on internal workout programs, distrust of new entrants, and general budget cutting.[293] The industry also started to shift from largely a face-to-face model toward providing more services over the phone and internet, prompting the emergence of larger counseling agencies with broader geographic coverage.[294]

Collectively, these changes caused many agencies to operate at a deficit and eventually to merge or cease operations, reducing the overall number of agencies by hundreds.[295] As the 2008 financial crisis worsened, demand for counseling increased to as many as 4 million consumers per year, although the percentage of consumers who qualified for DMPs declined due to unemployment.[296] Many counseling agencies diversified their offerings, with the majority of their counseling sessions shifting to topics that were eligible for other funding sources (e.g., bankruptcy and homeownership counseling), and later also to student loan counseling as concerns increased in that market (See Section 3.1.1, Section 3.2.1, and Section 3.2.2).[297] Further declines in fair share contributions and the 50 percent revenue cap under the 2006 tax law prompted some agencies to increase their fees to DMP participants, although there are legal and practical limits to their charges (See Section 2.2.3).

After the financial crisis passed, the number of accounts reported as enrolled in DMPs with counseling agencies remained relatively flat for the balance of the decade, although credit card delinquencies began to rise again in 2016.

3.1.3 Debt Settlement Regulation

While rules on bankruptcy and credit counseling tightened in the 2000s, some states loosened restrictions on the for-profit debt settlement sector. The modern brand of debt settlement companies appears to have sprung up in the early 2000s, at a time when two industry trade organizations reported having more than 200 members each.[298] Although more than half of states had banned for-profit "debt adjustment" services between the 1950s and 1970s, industry growth accelerated after the 2001 recession, BAPCA, and crackdowns on the nonprofit sector.[299] Some states adopted the Uniform Debt Management Services Act or considered other legislation to permit for-profit services during the course of the decade.[300]

However, as enrollments expanded, state regulators and consumer protection advocates became increasingly concerned about the combination of high up-front fees (in some cases, up to 40 percent of enrolled balances) and extremely low settlement rates (in some cases, less than 10 percent of enrolled balances).[301] By 2010, state regulators and attorneys general had taken at least 125 enforcement actions against debt settlement firms for fraudulent and deceptive acts and practices, several states tightened their requirements, and the Federal Trade Commission (FTC) and Government Accountability Office began highlighting concerns about the industry.[302]

These efforts culminated in the FTC's issuance of rules in 2010 under the Telemarketing Sales Act to prohibit DSCs from charging for their services until they have negotiated at least one settlement than the consumer has accepted and made a payment toward.[303] At that point, the DSCs may begin charging proportional fees based on either the amount of debt settled or the savings achieved, although most companies choose the former. The rules also imposed certain restrictions on the accounts that consumers use to accrue savings for settlements. The rules apply only to for-profit companies that use an instrumentality of interstate commerce and exclude bona fide nonprofit 501©(3) organizations and companies that use face-to-face processes.

After the rules took effect in late October 2010, so many companies went out of business that one trade association folded and the other shrunk to just 33 members.[304] Over the subsequent decade, however, increasingly large companies emerged as private equity firms decided that the industry was sufficiently legitimate to warrant investment. By 2016, some investment analysts estimated that about fifty "substantial" debt settlement firms were active in the market.[305] Although some government enforcement actions occurred later in the decade,[306] consumer enrollments among large firms increased substantially as credit card delinquencies began to rise in the last few years prior to the pandemic (See Section 2.2.4).

3.1.4 Credit Card Regulation

Federal regulators launched an update of regulations governing the credit card market in 2007. Although the first proposal focused largely on disclosure requirements, subsequent proposals focused on whether certain industry practices were unfair or deceptive.[307] The agencies issued final rules in late 2008, but then had to make rapid revisions after Congress adopted the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act) in 2009.[308] The last requirements took effect in August 2010.

The new laws imposed a broad range of requirements including an assessment of consumers' ability to pay, although Congress did not require lenders to verify income and expenses as they did with mortgage loans the following year.[309] The laws also restricted the circumstances under which issuers can change rates on existing balances, limited late and overlimit fees, and addressed a number of other pricing-related practices and disclosures.[310] With regard to overall debt loads, the laws required revisions to monthly statements to provide a toll-free number to obtain information about credit counseling as well as a calculation of what cardholders would need to pay per month to eliminate their current balance within three years.[311]

Satisfaction levels in consumer surveys about credit cards rose to all-time highs in the years after implementation of the new laws.[312] Although separating the effect of the laws from broader economic trends in connection with the 2008 financial crisis has been challenging, the CFPB found that the total cost of credit dropped by two percentage points between 2008 and 2012, and that consumers saved $2.5 billion in late fees and $1.5 billion in overlimit fees in 2012 alone.[313] However, subsequent research has found that the new disclosures made little change in monthly payment patterns. For instance, one study found that only one percent of accounts began paying the three-year repayment amount and that the number dropped further within a year.[314]

3.2 The 2008 Financial Crisis and Beyond

As deteriorations in housing prices and mortgage performance accelerated in 2007, federal officials increasingly turned their attention to that sector. Although the economy entered into a recession in December 2007, the collapse of Lehman Brothers in September 2008 triggered a liquidity crisis that drove consumer distress levels to the highest seen since the Great Depression.[315] Federal policymakers' response to the crisis was similarly historic, as Congress authorized $700 billion for the Troubled Assets Relief Program (TARP) in October 2008.[316] Most TARP initiatives focused on bolstering financial institutions and markets, but federal officials also pledged up to $75 billion for programs aiming to assist three to four million individual homeowners by the end of 2012.[317] These programs and other initiatives transformed mortgage workouts over the next several years through the adoption of more effective structures and more standardized, efficient procedures.

As the crisis receded, the U.S. economy settled into a long but slow period of growth. As resolution of distressed mortgages wound down, policymakers and researchers turned increasing attention to debt accumulation and distress in student lending markets. Markets for unsecured credit and debt resolution received relatively little attention, although technology innovations produced some evolution in market actors and communications channels.

3.2.1 Mortgage Workout Assistance and Regulation

By the time that federal officials launched their Making Home Affordable (MHA) initiative with TARP funds in February 2009, mortgage delinquencies and foreclosures had been increasing for more than two years.[318] Earlier foreclosure prevention initiatives had proven largely ineffective, in part because most loan modifications capitalized arrearages into existing principal in a way that actually increased borrowers' monthly payments.[319] More than half of the mortgage loans modified by the largest banks and thrifts in 2008 became at least 60 days delinquent again within 12 months.[320]

The structure of the main MHA initiative, the Home Affordable Modification Program (HAMP), was designed to address weaknesses in prior efforts by subsidizing modifications on eligible loans that would lower borrowers' monthly payments to 31 percent of gross monthly income for five years. The program used a standardized "waterfall" of modifications to achieve the payment reduction target, starting with reducing interest rates to as low as two percent, extending the loan term by up to 40 years, and forbearing part of the principal until the end of the loan term (or forgiving it, at the servicer's discretion).[321] Similar to other foreclosure prevention programs, HAMP eligibility was limited to loans where the "net present value" was positive because loan creditors were expected to recover more from the modified loan than from foreclosure, but the program standardized calculations as compared to private versions.[322]

BOX 8 LESSONS LEARNED FROM MORTGAGE MODIFICATIONS

While a full account of changes to mortgage servicing practices and lessons learned from the 2008 financial crisis is beyond the scope of this report, published analyses and interviews suggest several topics that are also potentially relevant to debt resolution channels for unsecured debt. They include:

Substantial payment relief is more likely to give consumers the space they need to stabilize their finances and reduce the likelihood of re-defaults. Loan modifications that included payment reductions performed so much better during the 2008 crisis than other structures that they became widespread even among proprietary modification programs that were not subject to HAMP requirements. Some studies found that modifications that included principal reductions performed even better than those that simply reduced interest rates, likely in part because they strengthened consumers' incentives to stay in their homes and made their loans more affordable over time.[323] Although HAMP did not require that servicers forgive principal and some stakeholders argued that offering such accommodations would create incentives for consumers to engage in strategic behavior, principal forbearance and forgiveness grew over the course of the crisis.[324]

Quick relief *before* borrowers have developed substantial arrearages substantially reduces re-defaults. To ensure that federal subsidies were targeted to truly distressed borrowers, HAMP required substantial documentation of hardship and restricted eligibility to consumers who were at least 60 days delinquent or at "imminent risk of default." Federal officials soon recognized that lengthy processing periods were pushing borrowers further into distress and began a series of further calibrations, although conversion from trial to permanent modifications remained a challenge throughout the program.[325] Studies of some HAMP vintages found that the percentage of loans that experienced serious re-defaults within two years was about twice as high among loans that were at least 210 days delinquent at the time of permanent modification as those that were no more than 30 days delinquent.[326]

Standardized waterfalls for assessments and concession types substantially increased efficiency and consistency, though multi-lender situations still proved challenging. The use of more standardized waterfalls and procedures became widespread even beyond HAMP as a broad range of stakeholders realized the advantages of greater consistency and efficiency in the face of unprecedented volumes of distressed loans. However, situations involving second mortgages proved substantially more challenging due to the need to coordinate between different parties. HAMP officials created additional incentives and programs designed to improve coordination between lenders, and the number of modifications involving second mortgages increased as time went on. However, multi-party workouts remained more challenging throughout the crisis.[327]

Training and technology systems are vital to helping provide continuity of contact to consumers at scale, particularly in surge situations. In response to widespread consumer complaints about inconsistent communications, lost paperwork, and other process breakdowns, HAMP and other sources imposed "continuity of contact" requirements.[328] But servicers struggled to hire and train personnel and improve technology systems to meet the new standards at scale. Information management remained a substantial pain point throughout the crisis recovery process, in part because servicers often maintained multiple information systems for performing different functions that did not easily transmit data to each other.[329]

Cooperative and creative communication strategies were critical to reaching consumers. Particularly after the scale of financial hardships accelerated and early loss mitigation processes failed to produce substantial improvements, servicers found it challenging to break through to distressed borrowers to alert them of their eligibility for specific programs. Some servicers knocked on doors and mailed prepaid cell phones, ornamental Halloween pumpkins, and gift mailboxes to consumers.[330] More generally, veterans of these initiatives emphasize the importance of keeping information simple, delivering it at just the right time and place, and providing multiple communications channels so that consumers can use whichever they feel most comfortable with and can switch to higher-contact channels if they encounter complications. Joint communications with government agencies also were helpful.

Changes to credit reporting codes and practices may have made it easier for consumers to access credit as their finances stabilized. As the crisis evolved, stakeholders began raising concerns that standard codes for "paying under a partial agreement" would reduce credit scores for loan modification recipients. Industry standards were revised to create new codes for modifications under federal and non-federal programs that were unlikely to affect consumers' scores because neither FICO nor VantageScore modified their models to take those codes into account.[331]

These features substantially increased financial relief to mortgage borrowers and reduced re-default rates relative to earlier programs.[332] Although HAMP's scale and speed did not meet original projections—more than one million borrowers began short-term "trial modifications" in the first year of the program, for example, but it produced only 550,000 permanent modifications by late 2010 and 1.136 million permanent loan modifications by late 2012[333]—the program went through multiple refinements at the urging of both advocates and industry, and private actors increasingly copied its key features.

At the same time, servicers also improved processes for "short sales" and deeds in lieu of foreclosure in combination with forgiving some loan balances to speed the resolution of debts for consumers who could not afford or did not want to stay in their homes. State and federal enforcement actions against large servicers and the issuance of comprehensive federal servicing regulations also helped to transform workout options and related practices.[334] For example, the federal servicing rules require servicers to begin reaching out to consumers by 36 days of delinquency to educate them about their options and to provide a comprehensive assessment of eligibility for all foreclosure alternatives at one time, rather than forcing consumers to go through sequential piecemeal evaluations.[335] See Box 8 for a discussion of some of the cumulative changes and lessons learned from these various initiatives.

By the time that foreclosure rates finally returned to pre-crisis levels in 2017, the MHA programs had obligated $33 billion in federal funds and resulted in 2.9 million homeowner assistance actions, and millions of additional modifications and other loss mitigation actions had been executed under proprietary programs.[336] Nevertheless, by some estimates 10 million people had lost their homes over the preceding decade.[337] Loan modification processes were further streamlined as HAMP drew to a close,[338] and again when the COVID-19 pandemic struck (See Section 4.1).

3.2.2 Student Loan Relief

As concerns about resolving distressed mortgage loans began to wane, both researchers and policymakers increasingly shifted their attention to student loan issues. The percentage of consumers with student loan debt and median loan balances had roughly doubled between 1989 and 2007, fueled by the increasing importance of college degrees to employment, escalating tuition and fees, and stagnation in federal grant programs.[339] Although post-secondary education is generally associated with higher incomes and greater financial stability over time, further increases in these trends and in delinquency and default statistics during the downturn and early recovery raised concerns that student loan overhangs were negatively impacting both individual households and the broader economy.[340]

For example, a growing range of surveys and academic research has probed whether student loan debt was slowing the pace of homeownership, small business formation, and retirement savings for younger generations of consumers.[341] Research has also highlighted substantial disparities in student-debt-to-income ratios, the pace of repayment, and delinquency rates among borrowers who leave school before obtaining their degrees, those who attend for-profit schools, women, and households of color.[342]

Federal policymakers responded to these and other concerns by launching additional repayment programs in 2007, 2009, 2012, and 2015. The new options included both a Public Service Loan Forgiveness (PSLF) program to cancel debts for borrowers who worked for qualifying employers after ten years of qualifying payments and several income-driven repayment (IDR) plans that set payments as a fraction of discretionary income and forgive any remaining balances for borrowers who make payments for 20 to 25 years.[343] Default rates among IDR participants proved to be about half that of borrowers on fixed-payment plans, and by 2017 enrollment in the new IDR programs had grown to about 27 percent of student borrowers and 45 percent of loan balances.[344]

BOX 9 LESSONS LEARNED FROM STUDENT LOAN RELIEF

A full account of the changes to student loan repayment plans and lessons learned from program adjustments in the 2010s is beyond the scope of this report, but several themes emerge that are similar to the issues with regard to debt resolution options for general unsecured credit with regard to mortgages (See Section 2.2 and Section 3.2.1). They include:

- **Administrative complexity increasing the importance of intermediaries:** By 2019, the federal government offered four major repayment schedule options, five IDR plans, and the Public Service Loan Forgiveness program.[345] Eligibility and program features varied as policymakers worked to balance competing considerations such as ensuring that relief was targeted to consumers who may otherwise struggle to repay their debts, the effects on recovery rates, and administrative considerations. Processes for already delinquent borrowers to transition into IDR programs are similarly complex. These changes have increased the importance of intermediaries in helping consumers to navigate the system, but poor communications and process breakdowns between servicers and federal agencies have exacerbated challenges particularly for low-income and highly distressed borrowers.[346]
- **Tradeoffs in lengthening workout plans:** Lengthening repayment periods from the standard 10 years to 20 to 25 years has helped to make IDR payments more affordable. Yet the longer terms have also increased the time with which households must carry student debt (potentially affecting whether and at what price they can access other types of credit), be potentially vulnerable to secondary shocks (as discussed further below), and wait to determine whether they will in fact be eligible for forgiveness. The financial and psychological effects have been further exacerbated by the fact that different programs vary as to accruals and capitalization during any periods in which IDR payments are too low to cover interest. Many participants have found that their balances actually continue to increase during the first several years of enrollment.[347]
- **Challenges with income documentation, budget volatility, and secondary shocks:** IDR programs typically rely on federal tax returns from the prior calendar year to assess initial and recertification eligibility, without factoring in expense volatility and without mechanisms for making real-time adjustments where incomes change. (Instead, borrowers must request manual adjustments from servicers.) Some surveys suggest some borrowers are still finding IDR payments to be unaffordable, particularly in the face of secondary shocks, and in some cohorts as many as 40 to 50 percent of borrowers have failed to submit recertification paperwork. While a 2019 law directs the Income Revenue Service and Department of Education to share data to make initial assessment and recertification easier, implementation is not complete.[348]

Yet borrowers continued to experience substantial difficulties in navigating the increasingly complex system, which was further exacerbated by information gaps and process frictions between loan servicers and the U.S. Department of Education.[349] These problems contributed to uneven enrollment especially among low-income consumers, substantial problems with income recertification requirements, and headlines about extremely low initial forgiveness rates. More broadly, surveys and interviews suggest that some borrowers still found the IDR payments to be unaffordable and were experiencing significant discouragement, frustration, and uncertainty about whether they would obtain long-term relief.[350]

Congress and Education Department officials adjusted program parameters, issued additional guidance for servicers and borrowers, and tightened servicing standards as the decade wore on. However, on the eve of the pandemic, student lending remained a significant policy concern (See Box 9). Although new borrowing trends dropped somewhat after the 2008 financial crisis, about 44 million consumers were carrying student loans in 2019.[351] Delinquencies and forbearances on student loans had surged, partially in response to natural disasters, and re-defaults were common. The Federal Reserve Bank of New York also reported a “stunning[]” increase in severe derogatory balances since 2012, finding that student loans had grown to represent 35 percent of all severely derogatory balances, greater than any other loan type.[352] Although nearly universal forbearance for federal student loans provided short-term relief during the pandemic, federal officials are also pursuing additional forgiveness options and process improvements (See Section 4.1 and Section 4.3).

3.2.3 Technology Evolution in Unsecured Lending and Debt Resolution

While policymakers remained focused largely on other consumer finances markets during the long, slow recovery from the 2008 financial crisis, technology has helped to facilitate the emergence of new business models and actors in markets for unsecured credit and debt resolution.

Technological changes were most pronounced in lending originations, where marketplace lenders became the largest provider of personal loans in the mid-2010s (See Section 2.2.1),[353] and Buy Now, Pay Later providers began a period of rapid growth late in the decade that is projected to reach 13 percent of the general unsecured lending market by 2023 (See Appendix B).[354] Both types of lenders are heavily dependent on technology for customer acquisition, underwriting, and service delivery. For instance, they rely heavily on underwriting algorithms and in some cases non-traditional data sources such as bank account information to speed loan approvals.[355]

Technology has also fueled the launch of various "personal financial management" (PFM) applications that offer budgeting, expense categorization, and similar services to consumers based on analyses of their bank account records, credit card statements, and other financial information.[356] In addition to spending and savings features, some PFM tools provide advice and services relating to managing credit accounts, such as repayment calculators, credit score simulators, suggestions regarding payment prioritization, due date reminders, and fee monitoring.[357]

Some fintechs are focusing more specifically on distressed borrowers, pursuing a range of business models, including both direct-to-consumer services and acting as a vendor to other industry actors (See Box 10). The founders of many of these latter startups come from credit originations or other broader financial services backgrounds, rather than from traditional debt resolution and collections companies.[358] They tend to rely heavily on technology platforms, newer communications channels, and predictive algorithms and data analyses. For example, some of the companies are relying heavily on chat, text, and email channels rather than phone communications with consumers, and some are working to leverage the same kinds of automated flows of bank account information for debt resolution activities that are being used for loan originations and more general PFM applications.

Incumbent companies have also upgraded their technology over the course of the decade, although not always to the extent of new entrants. For example, some banks have begun providing PFM services including credit card debt management tools to their deposit account customers, often using vendors to help power the services.[359] Many lenders have also substantially improved their customer-facing platforms over the past decade, and the share of active general purpose credit card accounts that are enrolled in large issuers' internet platforms and mobile apps has reached 80 percent and 60 percent, respectively.[360] While such platforms can be useful in working with distressed borrowers, stakeholders report that lenders are less likely to prioritize technology investments on improving back-office systems that can play a vital role in administering workout plans.

Nonprofit counseling agencies have also been working to upgrade their technology systems despite resource constraints (See Section 2.2.3). Various agencies have organized pilots of chatbot technologies and in at least one case the use of machine learning predictive models. Late in the decade, the National Foundation for Credit Counseling began working with individual agencies, lenders, and regulators to coordinate a series of technology and process pilots designed to help counseling

BOX 10 FINTECHS IN DEBT RESOLUTION

Several fintechs are focusing specifically on debt management issues and borrowers who are in significant distress.[361]

- **Creditly/Credit Genie:** Creditly is a digital platform that works with lenders and nonprofit credit counseling agencies to facilitate consumer communications, data collection, and analysis. The company also has a direct-to-consumer application called Credit Genie that offers financial analyses and cash advances, although its primary activities are focused on vendor relationships. For example, it can use automated feeds of bank account and credit report information to verify consumer incomes and certain expenses for purposes of hardship verification and budget analysis.[362]
- **Resolve:** Resolve is a public benefit corporation that provides a 100 percent online platform to help consumers negotiate lower interest rates and balances, text with debt advisors, monitor credit reports, and track income and spending. The platform facilitates both full balance workouts and negotiation of less-than-full-balance settlements, allowing consumers to pursue a mix of solutions depending on their circumstances. The company offers both free and paid monthly membership options.[363]
- **TrueAccord:** TrueAccord is a debt collection company that uses machine learning models and digital channels such as email and text to personalize communications based on predictions of which cadences, language, and channels are most likely to be successful in engaging individual consumers. In addition to relying on a marketing framework, the company offers flexible repayment plans and provides an online platform that allows consumers to self-service their debts.[364] TrueAccord's parent company has also started a separate venture called Engage that provides a digital platform for consumers to communicate with lenders and collectors about repayment plans, forbearances, and other matters.[365]
- **Upsolve:** Upsolve's initial app helps consumers navigate relatively simple Chapter 7 bankruptcy cases without having to hire an attorney. The nonprofit is supported by the Legal Services Corporation, charitable donations, and private attorneys who provide free consultations to platform users upon request. The app offers financial education resources and a self-service tool to help consumers gather documentation and generate automated forms that are reviewed by an Upsolve staff member. The tool also helps to determine which cases are complicated enough not to be suitable for the self-service model, and can connect those individuals with independent attorneys for a free consultation.[366] In 2022, the company obtained a favorable federal court ruling to use non-attorneys and volunteers to assist residents to fill out a one-page form and take other steps to avoid default judgments in debt collection cases.[367]

Another fintech, **LendStreet**, closed down in 2022. It had worked with lenders to provide loans to help consumers consolidate and settle debts more quickly, and then use the payments on the new loan to rebuild their credit. The company relied on cash-flow data from bank accounts in addition to credit report information to underwrite the loans [368]

agencies offer resolution options to a broader range of consumers. As discussed in Section 6, the pilots include testing potential alternative repayment structures, a protocol for working with DMP enrollees who encounter additional financial setbacks, and the use of digital platforms and automated data feeds to facilitate intake processes.

Federal policymakers did not substantially revisit the regulatory issues discussed in Section 3.1 later in the decade, although the Consumer Financial Protection Bureau embarked on rulemakings to regulate the offering of credit in connection with prepaid cards, underwriting processes for payday and other high-cost credit products (later partially rescinded), and implementation of the Fair Debt Collection Practices Act.[369] As work on the debt collection rule was concluding, the CFPB organized a convening on "Evolutions in Consumer Debt Relief" on March 10, 2020. Three days later President Trump declared the COVID-19 pandemic to be a public health emergency.[370]

4. THE COVID-19 DOWNTURN

The March 2020 lockdown produced more severe unemployment than either the 2008 crisis or the first several months of the Great Depression.[371] Lenders raced to hire and train new customer service representatives in an all-remote environment, and credit counseling agencies, debt settlement companies, and bankruptcy professionals braced for a flood of distressed borrowers as households struggled to adjust to income disruptions, increased medical costs, and other financial upheaval. Households of color were particularly hard hit, with substantial disparities in infection rates, hospitalizations, and deaths, as well as in unemployment and other financial impacts.[372]

As the months wore on, successive waves of federal stimulus and unprecedented lender accommodations created breathing room for many households. Millions of families responded to the general uncertainty by working to pay down credit card debt and build savings. Credit scores rose substantially, particularly among lower-scoring tiers, while delinquencies and debt resolution enrollments dropped. But not all families were able to improve their circumstances, and as pandemic relief initiatives expired and inflationary pressures increased sharply at the close of the second year of the pandemic, financial distress levels started to rise again. While debt resolution intermediaries have faced their own challenges over the last two years, stakeholders are feeling increasing urgency to address critical issues as discussed further in Section 5.

4.1 Short-Term Relief Initiatives

While the federal response to the 2008 financial crisis focused most intensely on stabilizing financial institutions and markets, the response to COVID focused most intensely on individual consumers and general commerce.[373] The first major wave came in the March 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provided $1,200 stimulus checks to individuals making less than $75,000 a year, expanded unemployment eligibility and provided an additional $600 per week in benefits, increased housing program support, and established the Paycheck Protection Program to help small businesses and keep workers employed.[374] Initial relief began flowing within a matter of days, although systems limitations and other implementation challenges created gaps and disparities in how quickly many households could access the relief, particularly among households of color.[375]

Borrower relief initiatives were also a major focus in early days of the pandemic, particularly while other initiatives were still being stood up. The CARES Act contained three specific provisions focusing on loans and credit reporting. In crafting and implementing the requirements, both Congress and federal regulators built on the lessons learned in the 2008 financial crisis as discussed in Section 3.2.1:

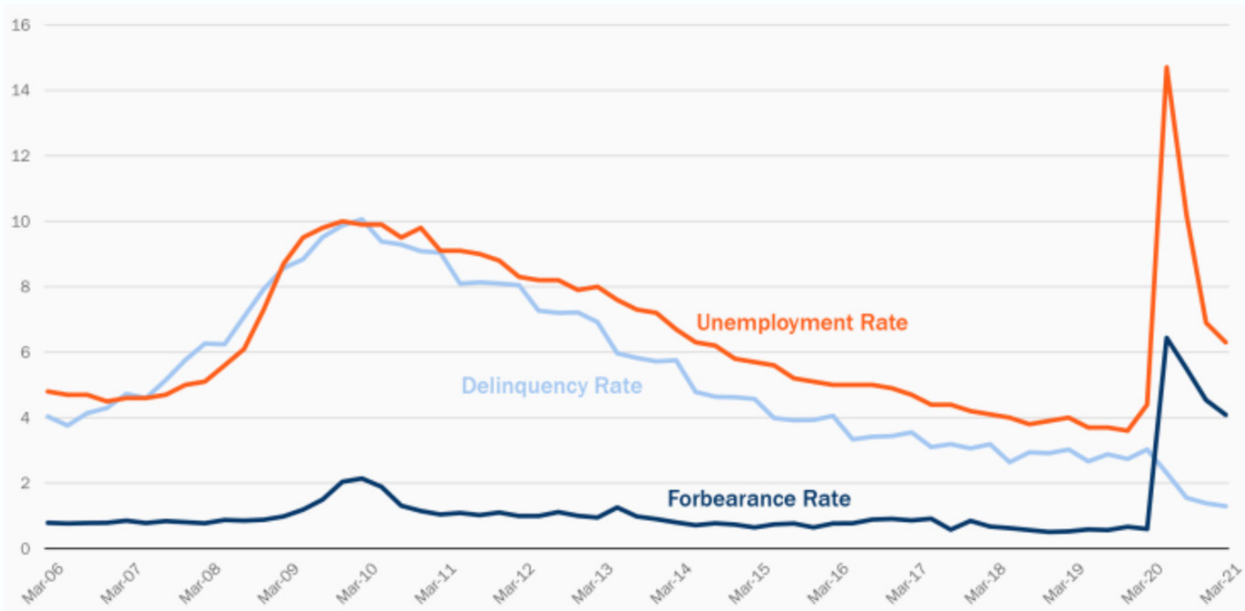
- **Mortgage forbearances:** The law created a right for homeowners with federally backed mortgages—which make up about 70 percent of the market—to obtain 12 months of forbearance (later extended to 18 months) on their loans if they experienced pandemic-related financial hardships. Consumers were not required to provide detailed hardship verification, and federal officials directed lenders to allow borrowers to add their missed payments to the end of their loans if they could not afford to make up shortfalls immediately after the end of their forbearance periods.[376]
- **Automatic forbearance on federal student loans:** The CARES Act provided six months of automatic forbearance for holders of most federal student loans. Both the Trump and Biden Administrations extended the initial period, with the current sunset scheduled for January 1, 2023.[377]
- **Credit reporting processes:** A third provision was designed to reduce the chance that consumers' credit scores would be hurt if they received a COVID-related accommodation on any credit account—including accommodations on credit cards, auto loans, and installment loans that were not mandated by the underlying law. Specifically, the reporting provision required that the accounts for consumers that were current before the pandemic continue to be reported that way when they were obtained and complied with the terms of any accommodations, and that loans that were already delinquent continue to be reported at that same level of delinquency while consumers complied with the terms of any accommodations. Because payment history is the largest single component of credit scores, the provision reduced but did not eliminate the risk that accommodations would negative effect consumer scores.[378]

While the CARES Act did not specifically dictate that lenders provide particular accommodations for loans other than federally related mortgages and student loans,[379] federal financial regulators urged other lenders to work closely and flexibly with borrowers in the initial months of the pandemic.[380] Although many credit card issuers had stopped offering distinct short-term relief programs in the years prior to the pandemic, most began offering payment deferrals of varying lengths (ranging from one to six billing cycles) immediately after the lockdown. Waivers of late or other fees were also relatively common, though most lenders did not suspend accrual of interest during deferment periods and the percentage of accounts that received interest rate reductions did not increase substantially after the lockdown.[381]

Enrollment in credit card deferral programs peaked in Q2 2020, affecting nearly three percent of accounts and seven percent of balances.[382] In an August 2020 consumer survey, the likelihood of having received assistance (including deferrals, rate reductions, and adjustments to credit lines) from credit card issuers was highest among respondents with incomes less than $60,000, consumers who had lost income, and renters. Nearly 20 percent of non-White respondents reported receiving assistance from credit card issuers compared to around 10 percent of White consumers.[383] CFPB analyses indicate payment deferrals were provided to one in six accounts held by consumers with subprime or deep subprime scores, compared to ratios of roughly one in ten for near prime and even smaller numbers of consumers with prime and superprime scores.[384] However, some surveys indicate that some lenders limited eligibility for short-term deferrals to consumers who were not already substantially delinquent, and a later CFPB survey found that only 20 percent of consumers who reported having difficulty making credit card payments obtained short-term forbearances.[385]

As initial deferrals expired, lenders adjusted their program criteria and worked to reach out to affected consumers about resolution options. Nearly 20 percent of credit card borrowers had actually kept making payments after obtaining an initial deferral, and many other consumers resumed making monthly payments without requesting forbearance extensions.[386] Some lenders reported that enrollments in longer-term programs rose as some borrowers sought additional relief.[387] However, some lenders saw an increase in delinquencies and charge offs as deferral programs ended, and balances enrolled in settlements by large credit card issuers also increased from 2019 to 2020, by 21 percent for pre-charge-off accounts and nine percent for post-charge-off accounts.[388]

FIGURE 7 DELINQUENCY, FORBEARANCE, AND UNEMPLOYMENT RATES



Note: Data source is Equifax 10% representative sample of the U.S. credit population
Source: Brookings Institute, Delinquency, Forbearance, and Unemployment Rates

By the time that additional waves of federal stimulus were enacted in December 2020 and March 2021,[389] the number of credit card and auto loan accounts with deferrals had dropped dramatically,[390] although many credit card issuers continued to offer some sort of short-term relief program.[391] Overall, more than 60 million consumers had at least one loan in forbearance within the first eight months of the pandemic, permitting them to miss $43 billion in loan payments, although as with credit cards a substantial portion of consumers also continued making payments on mortgage and auto loans.[392] Of the total balance of loans in forbearance, 50 percent were mortgages, 25 percent were student loans, and 25 percent were other loan products.[393] While research analyzing the effects of pandemic-era forbearances and the CARES Act reporting requirements is still evolving (See Appendix C), the results were so successful relative to mortgage market experiences in 2008 that some stakeholders have advocated to make forbearances a more consistent and distinct part of future loss mitigation waterfalls.[394]

4.2 Decline in Demand for Debt Relief

Households who were able to avoid major income disruptions during the pandemic worked to shore up their finances in light of the initial lockdown, stimulus and accommodation programs, and broad economic uncertainty. Savings rates soared to unprecedented levels as shown in Figure 8,[395] while credit card balances dropped 14 percent over the first year of the pandemic.[396] The balance declines were driven in part by reductions in spending activity that did not fully recover until vaccinations became widespread in spring 2021, but payment behaviors also shifted as the share of accounts with revolving balances fell to historic lows before starting to increase again in April 2021.[397] Balance and utilization declines were strongest among consumers who received forbearances on credit accounts, although some research suggests that credit card deleveraging across the general population had a much broader effect on credit scores than accommodation programs and the related CARES Act reporting rules.[398] New card originations also fell sharply in early 2020 and did not recover until mid-2021.[399]

FIGURE 8 PERSONAL SAVINGS RATE

Note: Shaded areas indicate U.S. recessions.
Source: U.S. Bureau of Economic Analysis (fred.stlouisfed.org)

In addition to the changes in credit reporting practices tied to pandemic forbearances (See Section 4.1), these conditions also contributed to substantial improvements in average credit scores particularly in lower tiers, creating a sharp contrast to the declines seen in previous downturns.[400] For example, while average credit scores increased eight points in the first year of the pandemic, lower score bands experienced average increases as high as 20 points.[401] Consumers with non-prime scores also reduced their average balances more in 2021 than in 2020, and the percentage of accounts with delinquencies of 90 days or more also continued to shrink in 2021. By late 2021, bank charge offs had dropped to the lowest rate since at least the mid-1980s.[402] Debt collectors also reported unprecedented payment levels.[403]

Although debt resolution providers had braced for a surge early in the pandemic, demand actually dropped substantially consistent with these broader trends. The number of personal bankruptcy filings declined by nearly 230,000 from 2019 to 2020 and by another 125,000 in 2021, bringing 2021 filings to 47 percent of 2019 levels.[404] The National Foundation for Credit Counseling reports less dramatic but still substantial drops in the number of consumers seeking counseling and enrolling in debt management plans with its members through Q2 2022. At the same time, a substantial number of existing DMP enrollees were able to pay off early using stimulus funds. Interviews with debt settlement companies suggest similar trends among existing and new clients.

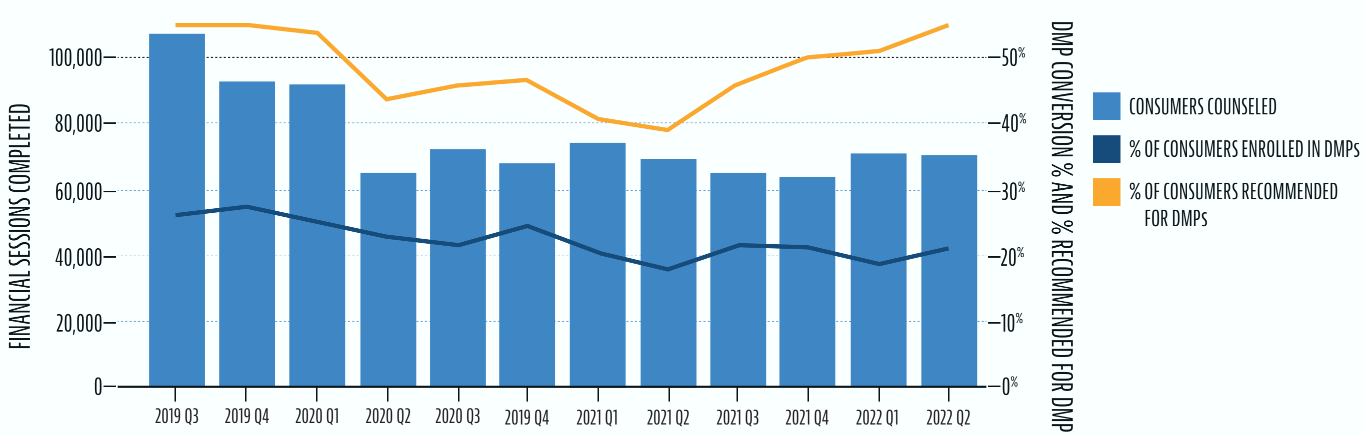
Beyond the general availability of stimulus funds and continuing mortgage and student loan accommodations, academic research and stakeholder interviews suggest that several other dynamics have helped to shape demand for debt resolution as the pandemic has evolved. During the initial lockdown, for example, obtaining services remotely was challenging due to logistical issues. Stakeholders also report that the level of economic uncertainty was so intense that some consumers felt that they could not commit to multi-year repayment plans, while others found that they were too distressed to qualify for some options. For instance, the percentage of counseled consumers who were recommended for debt management plans dropped substantially in early 2020 and again in early 2021. By mid-2022, eligibility statistics among NFCC member agencies had rebounded to pre-pandemic levels, but counseling demand and the DMP enrollment rate remained substantially lower.

TABLE 2 BUSINESS AND NON-BUSINESS BANKRUPTCY FILINGS 2017-2021

YEAR	BUSINESS	NON-BUSINESS	TOTAL
2017	23,157	765,863	789,020
2018	22,232	751,186	773,418
2019	22,780	752,160	774,940
2020	21,655	522,808	544,463
2021	**14,347**	**399,269**	**413,616**

Source: United States Courts, Annual Bankruptcy Filings Fall 29.7 Percent (Jan. 28, 2021)

FIGURE 9 QUARTERLY CONSUMER COUNSELING AND DMP ENROLLMENT VOLUME, 2019-2022

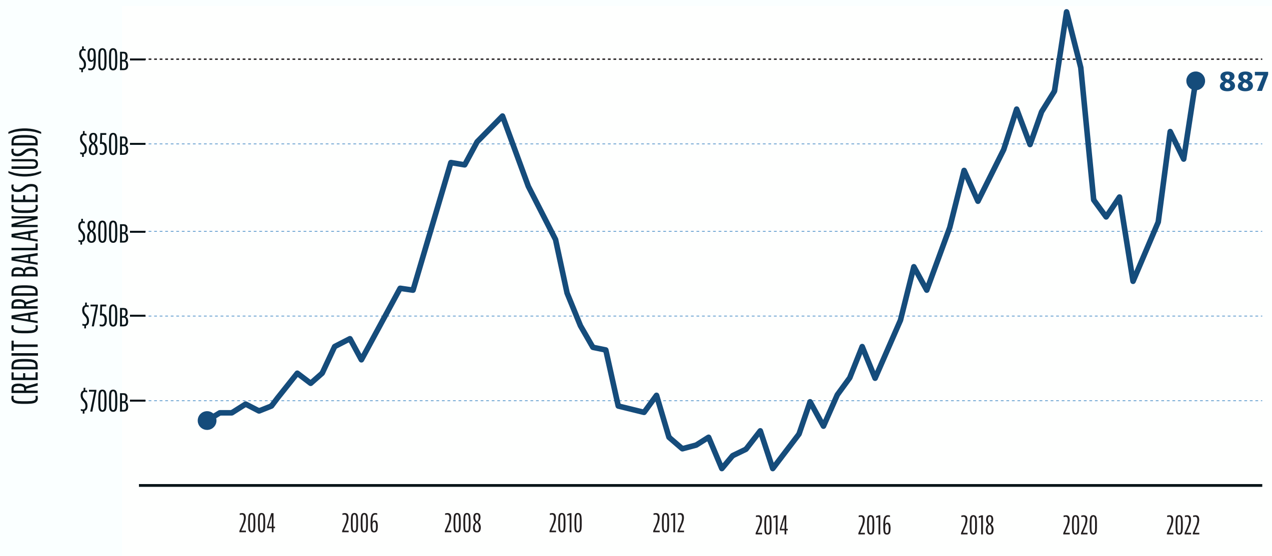


Source: National Foundation for Credit Counseling

4.3 Increasing Pressures in 2022

As the last round of stimulus payments ended and inflationary pressures jumped sharply starting in late 2021, the financial progress made by many households earlier in the pandemic began to erode. While employment has remained strong, annual increases in the prices on various categories of consumer goods set 40-year records repeatedly in 2022, housing costs have jumped substantially in both rental and purchase markets, and the Federal Reserve's attempts to constrain inflation by raising interest rates are driving up the cost of carrying debt.[405] These increased costs are having an increasingly significant impact on both savings and debt levels.

FIGURE 10 AMERICANS ARE RELYING MORE ON THEIR CREDIT CARDS



Source: New York Fed Consumer Credit Panel/Equifax, Abha Bhattarai/The Washington Post

As of June 2022, data from the JPMorgan Chase Institute shows that families' median checking account balances in the bottom three income quartiles had dropped below the two stimulus peaks that occurred in spring 2020 and spring 2021, although they were still above January 2020 levels.[406] A July 2022 survey by PYMNTS.com and Lending Club found that consumers who were living paycheck to paycheck and struggling to make ends meet had depleted nearly half their savings in 12 months, and that one-third reported that they would not be able to cover a $400 emergency.[407] In contrast to patterns early in the pandemic, the percent of income not being spent on taxes or personal expenses reached a low point in 2022 that has not been seen since the years after the 2008 financial crisis, hovering between 5 and 5.5 percent, as shown in Figure 8.[408]

Debt levels have also rebounded substantially. Buy Now, Pay Later originations among the nation's five largest lenders jumped from 43 to 63 million loans and $6 billion to almost $9 billion in balances during a record holiday season in Q4 2021, and recent growth is focusing on financing for groceries, gasoline, and other basic expenses (See Appendix B).[409] Credit card balances jumped by $100 billion between Q2 2021 and Q2 2022—their largest annual increase in two decades—with $46 billion growth in Q2 2022 alone. Total credit card debt levels are approaching pre-pandemic highs (See Figure 10), and delinquencies among low-income and subprime borrowers are also approaching pre-pandemic levels.[410] While mortgage delinquencies remain low, the number of serious delinquencies is 45 percent higher than it was prior to the COVID-19 pandemic.[411] The Federal Reserve's interest rate increases to curb inflation are affecting the cost of existing adjustable-rate credit cards and mortgages, as well as driving up the price of new borrowing. For instance, credit card rates have hit 30-year highs and are expected to continue rising [412]

In August 2022, the Biden Administration exercised an additional pandemic relief lever by announcing that it would further extend student loan forbearances through January 2023, forgive remaining balances for roughly 20 million borrowers, propose an additional income-driven repayment plan that would reduce monthly payments by about half for undergraduate loans, and make further reforms to existing programs.[413] However, many of the initiatives are not expected to take effect until well into 2023, particularly where rulemaking is required prior to execution, and may be subject to legal challenges.[414]

Other signs of cooling remained mixed as of early fall 2022. For instance, while home purchases slowed in the face of increased housing prices and higher costs of borrowing, the shift appeared to be creating further pressures in rental markets.[415] Although gas prices eased by more than 10 percent and some consumer surveys had started to trend more positive during the summer,[416] unexpectedly large increases in the consumer price index in August and September are expected to lead to additional large interest rate hikes by the Federal Reserve.[417]

Together, these conditions are increasing concerns that the anticipated surge in demand for debt relief support after the onset of the pandemic may soon strike. Although debt resolution providers themselves have faced economic uncertainty and upheaval over the past two years, many are bracing for deepening challenges ahead. At the same time, many stakeholders hope that there may also be opportunities to validate new approaches and to build greater momentum around market and policy initiatives in light of continuing economic stressors, increased awareness of racial equity issues, and a deeper appreciation of the importance of increasing the resiliency of financial systems and households to withstand future shocks. Rather than assuming that conditions and practices revert to 2019 patterns, they question whether there are ways to build on the experiences of the pandemic to strengthen households' financial stability and to improve options for those consumers who experience future shocks.

5. KEY ISSUES AND CHALLENGES

As stakeholders ponder strategies for helping consumers recover more quickly from personal and broader economic crises such as COVID-19, the developments discussed above help to underscore both the importance and the challenges of improving debt resolution options for unsecured credit. Up to a point, such credit can help many households smooth income and expense disruptions as well as finance purchases of durable goods. However, general unsecured credit can also contribute to financial distress where debt levels or pricing have become unsustainable, and the coordination challenges and limitations of existing workout structures can become obstacles to households' efforts to recover from prior shocks and make long-term investments in their economic futures.

Some policy debates relating to these issues are focusing on changes to underwriting and other lender practices that could reduce the risk that consumers become overwhelmed with unsecured debts in the first instance (See Appendix B). Recent developments have also substantially strengthened interest in whether changes to credit reporting and scoring practices could reduce the potential downstream effects of past financial shocks (See Appendix C). Although they are beyond the scope of this report, broader proposals to strengthen insurance and public safety net programs could also reduce the incidence and length of borrower distress. Indeed, some research suggests that lenders have responded to past improvements in unemployment compensation and Medicaid coverage by reducing interest rates and improving credit access for the most vulnerable households, leading to further improvements in resiliency and welfare.[418]

Yet similar to what has already been occurring in mortgage and student lending, there is also a critical need to improve back-end processes and workout structures in light of the policy concerns discussed above. Front-end initiatives and programs to address specific exogenous shocks such as national economic downturns and natural disasters may not be sufficient to stabilize households who are dealing with individual illnesses, localized or individual job losses, or domestic events such as divorce or the death of a partner.

As stakeholders consider ways to improve the current debt resolution ecosystem for unsecured credit, many are focusing on the potential for new workout plan structures and data and technology innovations to facilitate better outcomes at scale. Proponents believe that such changes could provide repayment plans that better meet households' needs as well as improve the detection of early warning signals, the accuracy of diagnostic and prediction tools, and communications among market actors. More broadly, some stakeholders argue for a reconceptualization of debt resolution processes to center on long-term consumer outcomes and relationships, suggesting that expanding the focus beyond simply closing out individual overdue accounts could improve outcomes for lenders as well as for borrowers and the broader economy.

This section outlines some of the key questions in improving the options for resolution of general unsecured credit going forward, while Section 6 discusses how new research may shed insight on many of these issues.

5.1 Diversifying and Tailoring Workout Structures

Many debt resolution stakeholders are focusing on the potential for new workout plan structures to improve consumer outcomes. At the most basic level, potential improvements could address some of the fragmentation and gaps in current offerings, as well as the need for mechanisms to address situations in which consumers experience a second financial hardship before they have recovered from an initial shock. More broadly, however, some stakeholders suggest that there could be potential for tailoring different workout structures to better meet the needs of particular consumers, particularly if paired with better predictive analytics (See Section 5.2).

The most immediate concern for many stakeholders is addressing gaps in the existing system. As discussed in Section 2.2.2, some non-bank lenders simply do not provide standardized workout plans either directly or through credit counseling agencies. Banks provide certain alternatives, but they may have no immediate permanent workout structure to offer before charge off to consumers who cannot afford to pay their full balances in 60 months or to complete a settlement within three months. Creating additional options can be complicated and involve tradeoffs for consumers and lenders alike, yet *not* providing an early workout structure in these circumstances also has substantial potential drawbacks. For consumers, the most immediate effects may include additional accrual of interest and fees, collections calls, and delinquencies reflected on their credit reports. Over time, delays may also increase the risks that consumers' financial situation continues to deteriorate and that they turn to higher-cost debt resolution options in the interim.

A second concern is how to reduce "breakage" where households encounter additional financial hardships after initial enrollment in installment resolution structures such as debt management plans, multi-payment LTFB settlements, and Chapter 13 bankruptcy filings. In the absence of protocols for dealing with secondary hardships, consumers may tend to drop out of their existing programs, leaving them even worse off than before if they are subjected to additional interest and fees for the enrollment period. In some cases, restrictions on the total length of workout plans can become an obstacle to working with such consumers to help them restabilize their finances a second time.

Beyond these immediate concerns, some stakeholders have suggested that there is an opportunity to develop workout structures that are better tailored to meet the needs of particular households, for instance by providing some built-in flexibility regarding payments in heavy expense months (such as back-to-school periods for working families) or that specifically provide for access to emergency credit in the event of future shocks.[419] Proponents suggest that such structures might be less prone to breakage and substantially more appealing to consumers who may be worried about their ability to meet rigid payment requirements for several years.

For any of these ideas, however, stakeholders emphasize that developing new workout plans can take substantial time and effort, for instance in reprogramming systems, making accounting and credit reporting changes, and coordinating with regulators and other market actors. The fact that new workout structures can also present potential tradeoffs for both lenders and consumers—for instance by increasing short-term costs to lenders or by changing practices in ways that might reduce consumers' arrearages but have greater negative effects on their credit scores and future cost of credit—also increases the stakes for both lenders and policymakers in considering potential adjustments. Stakeholders suggest that publicly available research that demonstrates the potential benefits of specific strategies could facilitate updates in regulatory guidance and the adoption of more consistent market practices.

5.2 Improving Detection, Diagnosis, and Prediction

Debt resolution stakeholders are also focusing on the potential for new data and analytical techniques to facilitate more nuanced diagnoses and predictions of what workout strategies and structures are likely to succeed for individual distressed borrowers. While some organizations are using federal statistics on general spending patterns to suggest potential areas for expense reduction, stakeholders are primarily interested in the potential use of data from consumers' bank and prepaid accounts to analyze households' individual finances.

As documented in the loan originations context, such information can provide a detailed picture of inflows, outflows, and reserves for particular households. While traditional credit reports typically only reflect payment of certain types of expenses and are updated on a monthly batch basis, transaction account information can provide a more timely and holistic picture of households' overall finances. Technologies for transferring such information electronically have improved substantially over the past 20 years, laying the groundwork for developing more nuanced analytical models to identify particular patterns of financial distress and potential resolution strategies.[420]

However, using such information to improve debt resolution outcomes at scale will likely require the resolution of important policy and market questions about which parties are best situated to access and use such information on behalf of consumers, consumer protection standards for data transfers and usage, and access timing questions. While such information could potentially be useful for monitoring and identifying early signs of distress as well as for evaluating which debt resolution strategies are most likely to succeed for consumers who are actively seeking relief, various market actors are differently situated as to their practical ability to access and use the data for such activities at different points in time. This challenge is prompting some countries to facilitate earlier engagement with consumers through both subsidies and regulatory requirements (See Box 11).

The logistics of accessing consumers' bank account information can also be challenging. Lenders and intermediaries must obtain consumer permission to access bank account information held by other financial institutions. While some lenders may obtain permission during the originations process to use such information for ongoing underwriting or servicing purposes,[421] trust levels between consumers and lenders may deteriorate as distress levels increase. Nonprofit counseling agencies typically collect detailed financial information about consumers' finances, they tend to have fewer technology resources than for-profit actors and may not connect with consumers until distress levels are already high (See Section 2.2.3). Some fintechs and banks are starting to provide personal financial management tools that include some debt-related features (See Section 3.2.2).

Broader market practices and regulatory protections for transfers of bank account data between financial institutions are also evolving. Such transfers generally involve the use of an intermediary called a data aggregator to collect the information from banking platforms and deliver it to end users, but the technologies, processes, and regulatory protections for effectuating such transfers are continuing to shift.[422] A forthcoming rulemaking by the Consumer Financial Protection Bureau could set standards and resolve various regulatory questions around general transfers of bank account data, but it may not focus specifically on access and data usage in the context of distressed borrowers.[423]

BOX 11 PROMOTING EARLY DETECTION AND INTERVENTION

Engaging with consumers who are building up substantial unsecured credit balances or otherwise beginning to experience increasing signs of distress can potentially lead to better consumer outcomes than waiting until a financial shock or substantial delinquencies have already occurred. However, consumers may not affirmatively seek assistance at early stages, and lenders may hesitate to reach out in part due to concerns that such contacts would be deemed intrusive or would encourage consumers who can in fact repay to begin seeking concessions. Other third parties often lack sufficient information at early stages to be able to connect efficiently with consumers who are most at risk of accelerating distress.

Several countries are working to facilitate earlier engagement with consumers who are starting to become overwhelmed by unsecured loans, both by subsidizing access to financial counseling and other debt resolution services and by mandating early outreach by lenders:

- The Australian federal government subsidizes free national debt helplines that provide initial counseling and refer consumers to local nonprofit agencies that also offer free services.[424] New Zealand also provides free access to a debt counseling helpline and services.[425]
- In Canada, consumers can choose between debt management plans administered by credit counselors, a court-approved process called a "consumer proposal" that is administered by a licensed solvency trustee to resolve debts up to $250,000, or full bankruptcy proceedings. Depending on consumers' financial situations, DMPs may eliminate rather than simply reduce interest payments. Interviews indicate that creditor funding of DMPs is more standardized than in the United States.[426]
- South Korea has established a quasi-governmental organization, the Credit Counseling and Recovery Service, to provide counseling and administer various debt relief programs. In 2019 it implemented a new program for consumers who are less than 31 days overdue on their payments. Enrollment costs are capped and fees are waived for consumers on public assistance.[427]
- The United Kingdom requires credit card issuers to reach out to borrowers who are in "persistent debt," which is defined as having paid more in interest, fees, and charges than in principal for at least 18 months. At 18 and 27 months, lenders are required to explain the consequences of failing to make larger payments and to provide information about debt advice services. If persistent debt continues for 36 months, lenders are expected to offer options to reduce the principal over three to four years and suspend accounts if consumers need forbearance to repay or do not respond.[428] The United Kingdom also provides free access to debt counseling services.[429]

In the United States, federal law requires credit card statements to provide a toll-free line to obtain information about credit counseling and debt management, but the federal government does not subsidize the actual services in the same way that it does for housing-related topics.[430] Banks can also receive credit under the Community Reinvestment Act for supporting housing counseling and financial literacy activities targeted to low- and moderate-income consumers, although current materials do not specifically state whether support for counseling distressed borrowers is also eligible.[431]

5.3 Reducing Coordination and Communications Challenges Among Market Actors

Stakeholders also see potential for evaluations of workout plan innovations and diagnostic tools and for other technology improvements to reduce some of the broader coordination challenges among different industry segments that make unsecured credit so complicated relative to other markets such as mortgage lending.

As reflected in Section 2.2, the fact that no one unsecured lender may be able to provide sufficient payment relief to allow distressed borrowers to restabilize their finances creates a classic collective action problem, where lenders could potentially achieve better results if they cooperate together yet also have strong incentives to act individually to maximize recoveries relative to their peers. The presence of multiple types of intermediaries focusing on different debt resolution strategies and business models further complicates intra-industry dynamics. These factors can shape what debt resolution options are available to individual consumers, for instance where lenders refuse to participate in a debt management plan unless all other lenders join or to work with debt settlement companies.

These complex dynamics cannot be resolved simply through technology changes, but stakeholders see ways in which innovations could potentially reduce some sources of friction. For example, many interviewees suggested that public research comparing the outcomes of existing debt resolution processes and workout structures with the potential innovations discussed above could potentially help build confidence among industry actors not only in changing their internal operations and systems but in adjusting the way that they deal with other lenders and intermediaries. They also point to the potential for application programming interfaces and enhanced digital platforms to increase the speed, accuracy, and security of communications and data transfers between different industry parties.

These changes can also potentially substantially benefit distressed borrowers, for instance by producing more reliable information about what debt resolution structures might best meet their needs and enhancing digital platforms, chat communications, and other channels to make it easier for consumers to access and provide information.

At the same time, stakeholders emphasize that structural and competitive factors can also potentially complicate innovation initiatives and other efforts to reduce process frictions within the broader debt resolution ecosystem, for instance due to resource constraints of nonprofit counseling agencies and concerns about particular debt settlement company practices. Even simply testing innovations can require substantial coordination among market actors.

Accordingly, while many stakeholders are eager to test more creative structures and processes, they also see a long-term need for complementary policy and market initiatives to encourage greater consistency and efficiency across the debt resolution ecosystem.

5.4 Centering Debt Resolution Around Consumer Outcomes

Stepping back from specific data, technology, and workout structure innovations, some stakeholders argue that outcomes for both consumers and lenders alike could potentially improve if debt resolution was reconceptualized to focus more intensely on promoting long-term household stability and customer relationships rather than simply closing out individual overdue accounts.

Such an approach would potentially blend the types of innovations discussed above with increased attention to the cognitive, emotional, and logistical challenges that consumers face in dealing with mounting distress. For example, while better digital platforms can be an important communications tool, many stakeholders argue that the optimal approach is to provide multi-channel options that allow consumers to obtain varying levels of direct human support depending on their personal comfort levels and evolving circumstances.

Some stakeholders also suggest that prioritizing more flexible workout structures that allow consumers to maintain ongoing relationships with existing lenders rather than simply paying off their closed accounts could potentially lead to better results for both parties as households stabilize and begin making long-term investments in their financial futures. In a sense, creating such structures would be similar to the emphasis during the 2008 financial crisis on expanding mortgage loan modifications that would keep people in their homes rather than just resolving the current mortgage debts through the foreclosure process and leaving households on their own to try to stabilize and reestablish access to credit going forward. A few lenders report that they have begun modifying some of their programs or are thinking about doing so in light of evidence during the pandemic that some consumers who were clearly in substantial distress were nonetheless reluctant to enroll in options that required them to permanently close their accounts.

Other stakeholders focused on the need for better understanding of consumers' goals and attitudes in approaching the debt resolution process, particularly when dealing with multiple lenders at the same time, as well as for tools that could help consumers better weigh potential tradeoffs between the timing and amount of direct costs, future impacts on credit reports and scores, and other ramifications of different debt resolution options. They expressed concern that consumers sometimes miscalibrate the downstream effects on credit scores, in some cases by failing to realize the negative effects of particular options and in other cases by placing too much emphasis on preserving their scores rather than concentrating on their basic finances.

However, these kinds of broader customer-centered innovations may require both a different mindset—one that relies more heavily on marketing strategies and positive reinforcement rather than traditional negative incentives to pay off debts—as well as earlier interventions, different concessions, and other changes to traditional processes even beyond the specific ideas discussed in earlier subsections. Despite the additional effort, proponents argue that such changes could be critical to building more rapid and inclusive recovery processes for both individual households and the broader economy.

6. CONCLUSION

As reflected in this report, the time is ripe for a broad assessment of the options available for resolving unsecured loans given the vital role such loans can play in both overcoming and contributing to financial distress, consumers' increasing vulnerability to income and expense shocks, available research and policy concerns regarding existing resolution options, and lessons learned from two record economic crises in less than 15 years. While many stakeholders agree that current debt resolution options produce poor outcomes for many consumers, making improvements will require overcoming significant knowledge gaps, coordination challenges, and resource limitations.

The forthcoming empirical research project by FinRegLab, conducted with The Ohio State University and Charles River Associates, will address many of these pressing policy issues by evaluating potential innovations in workout structures and data and technology adoption. It is based primarily on data from pilots that have been facilitated by the National Foundation for Credit Counseling, which has helped to recruit both member and non-member agencies to participate in testing innovations over the past few years. Specifically, the project will focus on:

» **Alternative workout structures for consumers who do not qualify for or want to participate in traditional debt management plans.** This includes evaluating pilots of multi-lender plans that allow consumers whose accounts have already charged off to settle multiple debts for less than full balance, as well as full-balance plans that spread payments over 72 months to reduce monthly payment amounts. Depending on data availability, it may include other analyses exploring the potential tradeoffs between the length of repayment plan and amount of recovery and the consequences of allowing additional debt and delinquencies to accrue as compared to accelerating charge offs.

» **Short-term programs to help consumers who experience income and expense shocks,** including pandemic relief initiatives and a pilot that deepens concessions for approximately six months to help DMP enrollees stabilize their finances and resume regular payments.

» **The outcomes of multi-lender debt resolution plans as compared to workouts with individual lenders.** This includes comparing outcomes across different debt resolution channels based on how many accounts consumers have with different lenders. Depending on data availability, it could also compare outcomes for consumers who obtain settlements negotiated with individual lenders with consumers who obtain relief through multi-party plans.

» **The use of digital platforms to facilitate consumer intake and communications,** including questions about user experience and automated access to bank account data.

Given the particular importance of building trust and reducing frictions in interacting with distressed borrowers, the project will explore best practices and effective communications strategies in digital communications.

» **Potential use of cash-flow data and more sophisticated predictive algorithms.** Use of bank account data to shed additional insights into household finances is becoming more common in loan originations, but it has not been explored widely in working with distressed borrowers. The project will probe use of the data to help assess what workout options may be most likely to succeed for particular borrowers, and possibly to gauge consumer outcomes in addition to use of consumer report and scoring data.

The empirical evaluations will begin later in 2022 with an assessment of pandemic-era effects on counseled consumers and analyses of short-term pandemic accommodations. In addition to the empirical research on the topics above, additional reports will explore the potential evolution of policy, regulation, and market practices based on extensive stakeholder outreach and FinRegLab policy and legal analyses.

The goal of the project is to take a broad-based look at potential innovations to support more rapid and inclusive recovery processes for consumers who experience personal or economic shocks. Developing a more comprehensive toolkit for resolving unsecured debt has important implications for individual households' financial stability and wealth building capacity, as well as for the nation's economy in overcoming longstanding racial wealth gaps and recovering from broader downturns.

APPENDIX A

Other Credit Rehabilitation Strategies

Separate from or in addition to working to resolve individual unsecured debts as discussed in the main report, consumers may pursue other assistance and strategies to rehabilitate their access to credit after periods of financial distress. These may include credit counseling as a standalone service (separate from debt management plans as discussed in Section 2.2.3), taking out secured credit cards or other "credit builder" loan products, and working with credit repair organizations.

A.1 Credit Counseling as a Standalone Service

As discussed in Section 2.2.3 and Section 3.1.2, nonprofit agencies provide a combination of services to distressed borrowers that include general budgeting analysis and advice and education about the range of debt resolution options, in addition to administration of debt management plans for consumers who are eligible and interested in enrollment. Most agencies also provide counseling programs on topics such as homeownership, reverse mortgages, student loans, and bankruptcy.[432]

A few academic studies have assessed outcomes for consumers who participate in counseling but do not enroll in DMPs. For instance, one study compared approximately 8,000 consumers who were counseled by five nonprofit agencies in 1997 but did not enroll in DMPs to individuals who had similar credit profiles and lived in the same zip codes but had not sought counseling from the same organizations.[433] The authors found evidence that scores initially declined for many counseled consumers, which they attributed to the hardship that prompted them to seek counseling. By 2000, the counseled group experienced larger score improvements than the comparison sample, particularly for consumers who started with the lowest scores. Counseled borrowers also experienced larger decreases in their number of bank card accounts, bank card utilization, and revolving debt, as well as in total debts, again with larger effects for counseled consumers with the lowest scores. After applying an adjusted model that was designed to account for differences in motivation and other "self selection" factors, the authors concluded that the score improvements were largely due to the selection factors but that the debt reductions were likely due to counseling.

A later study compared outcomes for about 6,000 consumers counseled by thirteen nonprofit agencies between 2013 and 2015 as part of a National Foundation for Credit Counseling program called Sharpen Your Financial Focus to about 6,000 consumers with similar credit records who had not received counseling.[434] The study found that counseled consumers experienced initial drops in their credit scores and an increase in delinquencies of 60 days or more, which is potentially consistent with experiencing a hardship that prompted them to seek out counseling. After the second quarter post counseling both metrics started to rebound, and by the sixth quarter matched the comparison group on 60-day delinquencies and were approaching the comparison group on scores. Score improvements relative to the comparison group were larger and statistically significant for counseled consumers who started with scores in the bottom quartile. The counseled consumers also reduced their revolving and total debt by substantially larger amounts than the comparison group.

A later related analysis of data from the same Sharpen Your Financial Focus initiative is described in Section 2.2.3.[435] As noted there, the study also found evidence to suggest that consumers who received counseling may have experienced additional financial shocks compared to the comparison group of non-counseled consumers. Following the two groups for five years, the study found that counseled consumers reduced their total debt and credit card debt by a statistically significant amount relative to non-counseled consumers with similar credit profiles, but that their credit scores still lagged the non-counseled group at the end of the study period. A decomposition of tradeline records found that counseled consumers' debt reductions were more likely to be due to charge offs, debt settlements, and bankruptcy than either DMP participants or non-counseled consumers.

A number of other studies have focused on other aspects of the counseling process that may affect consumer outcomes, such as the use of telephone or video delivery channels, the effectiveness of automated reminders, or the use of prize-linked financial incentives.[436]

A.2 Secured Credit Cards and Credit Builder Products

Consumers who are trying to improve their credit scores after past distress may turn to secured credit cards or other "credit builder" products as a way to build a new record of on-time payments. As product structures diversify, however, some stakeholders and research are raising concerns that some programs may actually pose risks to consumers' finances and generate data that existing models may struggle to evaluate properly in predicting default risk on more traditional loan products.

Secured credit cards, which have been offered for decades, peg the credit limit to the amount of funds that consumers have deposited into a special account as security in the event of non-payment.[437] A second type of credit builder loan that is offered by a number of banks, credit unions, and other lenders can be thought of as a delayed installment structure, where the loan funds are initially deposited into a locked savings account or certificate of deposit at origination and released as consumers make payments over time (typically 6 to 24 months).[438] A third set of newer credit builder products and apps link lines of credit to consumers' checking accounts in ways that facilitate the reporting of streaming subscriptions or other miscellaneous expenditures to credit bureaus. They are often structured to deduct the transactions automatically (or within a very limited time frame) from consumers' accounts, meaning that there is almost no chance that consumers do not make the payments.[439]

The secured credit card and delayed installment structures are the most widely accepted, although consumer advocates warn that it is important to review the account terms carefully.[440] Both product structures potentially allow consumers a way to build a record of on-time payments as well as savings. They are often priced lower than available unsecured options because lenders have little risk of loss, although some versions may still involve substantial interest rates that effectively cancel out any interest earned on the savings. Secured credit cards also generally provide less extensive rewards programs than traditional cards and often charge annual fees.[441]

Research on the ultimate effects of such programs is limited and mixed, suggesting that whether such programs help or hurt consumers' efforts to regain access to affordable credit often depends on the account terms, whether consumers have substantial pre-existing loans, and how quickly lenders transition borrowers to more lower-cost products. While some community-focused programs have reported relatively positive results,[442] some research suggests that the programs produce more consistently positive outcomes for consumers who have not previously had credit scores than for consumers who are working to restabilize after past delinquencies.

For example, a Federal Reserve Bank of Philadelphia study of secured credit cards from 2012 to 2017 found that consumers who lacked credit scores when they initially obtained the cards were far more likely to graduate to unsecured cards with the same lender within 24 months than already-scored consumers, and that lower existing scores were associated with lower graduation probabilities.[443] Graduation rates overall were low but had accelerated over the study period, with 20 percent of the accounts opened in 2017 graduating in 11 months.

A study commissioned by the CFPB also found varied outcomes from $600 credit builder loans where the principal was disbursed in increments as consumers made 12 monthly payments. Among consumers who had preexisting loans, credit scores actually declined on average by a few points due to both delinquencies on the credit builder loan and on the existing credit. Borrowers without existing debt increased their scores by an average of nine points, however, and borrowers who did not previously have credit scores were 24 percent more likely to have scores by the end of the program.[444]

Credit builder programs that are focused on reporting ongoing smaller or miscellaneous transactions do not appear to have been subject to significant research to date. Although there has been longstanding interest in increasing the reporting of significant recurring expenses such as rent, utility, and/or telecommunications payments and more recently in using cash-flow data from bank accounts or similar sources to underwrite consumers,[445] some stakeholders are expressing concern that existing credit scoring models are not designed to predict default risk based on product structures that virtually eliminate repayment risks for miscellaneous transactions.[446] In some cases, programs also advertise that they do not report certain data points (such as utilization ratios) in an effort to increase the positive effects on consumers' scores.[447]

A.3 Credit Repair Organizations

Credit repair organizations (CROs) do not offer a specific workout program for resolving cumulative debts, but rather focus on disputing potential inaccuracies in consumers' credit reports and other strategies that are designed to affect credit bureau information that forms the basis for credit scores.[448] Critics argue that these organizations charge high fees, often file spurious disputes with credit bureaus, and do not provide meaningful value to consumers.

The 1996 Credit Repair Organizations Act (CROA) aims to protect consumers from scams and abusive practices in the credit repair industry. CROA defines organizations that act to improve a consumer's credit standing for a fee as credit repair organizations. CROA requires credit repair organizations to give consumers a three-business-day cooling off period to cancel their contracts and prohibits demanding advance payments and attempting to mislead—or encouraging consumers to mislead—consumer reporting agencies or lenders about a consumer's creditworthiness.[449] In 2019, Google banned credit repair advertisements from its platform.[450]

Despite these steps, concerns about credit repair organizations' business practices remain. For example, the Federal Trade Commission shut down an operation in 2022 that advised consumers to "invest" pandemic tax benefits in credit repair services with little to no value via advertisements reading "Free Credit Repair From The Government."[451] Federal regulators warn consumers against companies that sound too good to be true, withhold information, or ask them to misrepresent information, and emphasize more generally that consumers can do anything that CROs can do legally for themselves at little or no cost.[452]

APPENDIX B

Lender Practices

Debates about underwriting and other lender practices that can affect the accumulation of general unsecured credit have flared periodically over the past decade. While many of them occurred in the context of payday and other high-cost credit—where the Consumer Financial Protection Bureau adopted and then rescinded regulations requiring a detailed ability-to-repay analysis[453]—some stakeholders have also pushed to strengthen credit card rules. The potential regulation and reporting of Buy Now, Pay Later loans are also generating substantial public attention as that sector's rapid growth raises concerns that some borrowers are becoming over-extended.

B.1 Changes to Credit Card Practices

As the ten-year anniversary of the Credit CARD Act has come and gone (See Section 3.1.4), a few stakeholders have continued to urge more rigorous minimum payment standards and underwriting requirements to address concerns about debt sustainability. For example, the National Consumer Law Center has called repeatedly for the CFPB to set minimum payment requirements to achieve pay off in five years as well as to strengthen the law's ability-to-pay analysis by underwriting based on a five-year amortization schedule rather than simply assessing consumers' ability to make minimum payments. The organization has also suggested carrying over ideas that had been raised during the payday rulemaking, such as using a residual income analysis that takes account of living expenses and evaluating lenders' default rates in determining whether their ability-to-pay analyses are sufficiently rigorous.[454]

More recently, a June 2022 report by Financial Health Network leaders called on the CFPB and federal banking regulators to use their authorities to increase credit card minimum payment requirements, arguing that the most widely used formula today—one percent of current balances plus interest and fees—is a particularly slow structure for paying down debts because the minimum principal owed further declines as balances are reduced. The report compares alternative minimum payment structures, suggesting that the best initial step might be to create new choice architectures that would for instance require consumers periodically to decide which minimum payment levels make the most sense for their financial situations.[455]

Regulators in a few other countries have increased their minimum payment thresholds for credit cards to reduce the accumulation of unsecured debt, and the United Kingdom has implemented a requirement that can lead to consumers' accounts being suspended after 36 months of persistent debt (See Box 11, Section 5.2).[456] The CFPB issued a request for comment on credit card late fee levels in June 2022,[457] but has not indicated that it is focusing debt accumulation issues.[458]

B.2 Reporting and Regulation of Buy Now, Pay Later Loans

Buy Now, Pay Later loans are a relatively new form of credit that are most commonly structured to allow consumers to purchase goods or services and pay them off in four or fewer installments without interest, so long as the payments are made on time via debit or credit cards. Lenders typically earn revenue by charging fees to retailers and in some cases from late fees to consumers.[459] While BNPL loans were first offered by a group of non-bank fintech lenders in connection with online retail sales, they are now being used by an increasing range of providers to finance such items as medical care, education expenses at for-profit schools, home improvements, groceries, gas, and even rent and utility payments. Many BNPL companies are also diversifying their product offerings and pricing structures to include longer-term loans, phone apps, and in some cases debit card programs, and credit card companies and networks are increasingly offering BNPL options as well.[460]

BNPL's rapid growth in volume as noted in Section 3.2.2 and Section 4.3 is prompting growing debates about increasing debt loads, how and when the loans should be reported to credit bureaus, and how they should be treated for purposes of various federal consumer financial laws. While proponents argue that the pay-in-four loans have substantial cost and other advantages relative to revolving credit card debt, a range of stakeholders has raised concerns that stacking of multiple loans could increase the risk of consumer defaults. Traditional BNPL lenders do not routinely report short-term loans to credit bureaus today, so neither they nor other types of lenders can easily evaluate the total number of loans a consumer may have outstanding across multiple providers.[461] Roughly 10 percent of borrowers are estimated to have been subject to late fees, although some online surveys report higher numbers.[462] Besides late or insufficient funds fees from some lenders, collateral effects can potentially include checking account overdrafts, budget shortfalls in connection with other expenses, adding to credit card balances to cover BNPL obligations, and reporting of missed payments to credit bureaus.[463]

Both credit bureaus and policymakers are encouraging BNPL lenders to increase information flows. Equifax has announced it will become the first credit bureau to create a formal process for including BNPL obligations in its main files, while Experian and TransUnion are working to increase access but partition the data from their main files.[464] In June 2022, the CFPB urged BNPL lenders and credit bureaus to ensure BNPL loans are both reported and incorporated into credit bureaus' main files in a standardized, consistent manner.[465]

However, while increasing the availability of information about outstanding BNPL loans could help lenders better evaluate consumers' debt obligations, feeding the information into existing credit scoring models is complicated because reporting practices are not consistent and current models have not been adapted specifically for BNPL data.[466] For example, the three main credit bureaus' data standards generally assume monthly payments and do not generally treat accounts as delinquent until they are at least 30 days past due. Thus, it is unclear how pay-in-four structures that typically last a total of eight weeks will be reported. In addition, even where all payments are made on time, BNPL data can affect credit utilization ratios differently depending on how the data are characterized and structured, as well as other metrics such as those relating to the age of accounts.

A FICO analysis of longer loans offered by a BNPL provider found that average effects on credit scores were slightly negative within the first three months where the data were reported using the format for installment loans, but emphasized that effects would likely be larger in both negative and positive directions if they were reported as revolving loans because credit utilization ratios on revolving credit play a significant role in FICO scores.[467] Stakeholder interviews suggest that it may be difficult to make scoring model adjustments until the volume and consistency of data reporting increase substantially.

Although some stakeholders have suggested that on-time BNPL loan payments could help consumers with thin or poor credit histories increase their access to credit, surveys suggest that consumers may be confused as to current practices and their impacts on scores. For instance, some surveys find about a quarter of respondents believe using BNPL loans will help improve their credit scores, while others find that a similar fraction do not even consider BNPL a form of debt and thus may not realize the risk that failing to pay could have negative effects on their scores.[468]

Beyond debates about credit reporting and scoring practices, stakeholders are focusing on the application of federal consumer financial laws to BNPL products. Consumer advocates are urging the Consumer Financial Protection Bureau to treat BNPL loans as credit card debt, which would trigger the Credit CARD Act's requirements to conduct ability-to-pay assessments discussed in Section 3.1.4 as well as other protections.[469] Some BNPL lenders emphasize that they do not perform full formal credit report checks or rely on credit scores, although in practice most of the nation's largest providers do rely on credit report information in some form at least for underwriting consumers who are new to the lenders.[470]

APPENDIX C

Consumer Reporting and Scoring Practices

The pandemic downturn and subsequent developments have renewed debates about whether and how to change consumer reporting and scoring practices to reduce the downstream impacts of past financial shocks. Some approaches would withhold or restrict the use of information, while others would provide greater detail and consistency. The effects of specific changes are fiercely debated in light of the complexity of current systems. This Appendix describes those systems before summarizing debates over specific changes and broader policy issues.

C.1 Overview of Current System

The U.S. consumer reporting system is made up of several thousand data sources, a small group of credit bureaus and predictive scoring model developers, and thousands of end users that rely on consumer reports and/or scoring models in underwriting credit and insurance, screening applicants for employment or housing, and other business activities. Different actors are subject to varying degrees of federal regulation and monitoring depending on what roles they play.[471]

For example, furnishing information to credit bureaus is voluntary under the Fair Credit Reporting Act, although companies that decide to provide information are subject to certain compliance requirements. Proposals that would impose new burdens on furnishers through either regulatory or industry standards often trigger debates about whether companies will simply choose to stop providing information, though gauging the likelihood of such risks is challenging given that furnishers often rely on credit reporting to incentivize consumer payments.

In the hub of the system, three nationwide consumer reporting agencies (NCRAs)—Equifax, Experian, and TransUnion—each maintain records on more than 200 million U.S. adults. Their main files consist mainly of information about current and prior loans, but they also obtain public records (such as bankruptcies) and information from debt collectors and holders of other types of consumer debt. In addition to those main files, the NCRAs also often maintain separate pools of more specialized information, own specialty reporting bureaus that maintain such information, or operate such pools on behalf of other entities. Credit report users must usually pay separately to access those records, such as payment history on payday loans or specialized tenant screening reports.

Companies such as the Fair Isaac Corporation (FICO) and NCRA joint venture VantageScore have developed generalized third-party credit scoring models that analyze information contained in the NCRAs' main files to predict the relative likelihood that a consumer will go delinquent or default on loans within 18 to 24 months. While the models are proprietary, they commonly consider such factors as past payment history, utilization rates, and mix of credit types. Scoring models may take substantial time to develop, validate, and implement. For instance, the most commonly used version today is FICO 8, which was developed based on data from before the 2008 financial crisis.[472] In addition to the generalized models, the scoring companies and individual credit bureaus also offer more specialized scores that are tailored to predict defaults on particular types of loan products.

Some sources estimate that third-party credit scores are used in about 90 percent of mortgage, credit card, and auto lending decisions, but individual lenders vary as to how they use the information. For instance, lender models may include not only third-party scores but also attributes from the underlying credit reports and/or proprietary scores that they have built internally. And because credit scoring ranges and distributions fluctuate over time according to economic conditions, lenders may increase minimum score requirements or impose other types of credit overlay rules in response to changing economic conditions even absent scoring model or regulatory changes.

Companies in several other sectors also rely on reports from NCRAs and/or specialty credit bureaus to screen and underwrite. Use of traditional credit scores for such purposes is discouraged or prohibited because they have not been validated for use in other settings, but some model development companies have created separate scoring models for use in insurance and rental tenant screening. Use of consumer reports and scoring models for these other purposes has not historically been regulated or monitored in as much depth as in the credit context.[473]

C.2 Proposals to Reduce the Effects of Past Financial Shocks

The COVID-19 pandemic and recent focus on racial justice issues have triggered substantial interest among a broad range of stakeholders about how to improve consumer reporting and scoring practices, particularly by reducing the downstream impacts of prior financial shocks. Some advocates and policymakers are focusing on general parameters such as the length of time that negative information remains on consumers' reports, noting that some European countries only maintain such information for three to four years instead of seven to ten in the United States.[474] Use of consumer report information for tenant and employment screening is also drawing heightened attention, particularly given concerns that poor practices could create additional obstacles when rental housing markets are already extremely tight.[475]

As described below, other developments and initiatives are focusing on specific types of shocks, such as natural and declared disasters, economic downturns, and medical expenses.

C.2.1 Natural and Declared Disasters

Many lenders have created short-term forbearance programs to work with consumers who have been affected by declared disasters, but the COVID-19 pandemic underscored that reporting and scoring practices are not consistent across relevant industry segments.

The NCRAs' current data standards provide several different methods for reflecting that a particular consumer has been affected by a natural or other declared disaster. After hurricanes such as Katrina (2005) and Harvey (2017), lenders increasingly used what are called "special comment codes" to note the existence of such a disaster or that a particular account is subject to forbearance.[476]

While most lenders will not use the special purpose codes unless consumers have specifically contacted them about a disaster, in the early days of the COVID-19 pandemic some lenders reportedly placed the codes on the accounts of consumers who did not actually seek pandemic relief. The impacts of particular codes also varies, in part because some credit scoring models ignore the codes, while others are designed to ignore certain negative payment history when either the natural disaster or forbearance codes are present.[477]

Although credit reporting and scoring practices became more standardized over the course of the pandemic, there is substantial interest among some stakeholders in revisiting disaster-related reporting practices more broadly. Interviews and anecdotal reports suggest some furnishers informally stopped or slowed reporting negative information for consumers who were affected by the pandemic,[478] although stakeholders are continuing to debate whether systematically withholding such information in the future would benefit consumers as discussed below. The House of Representatives passed two versions of a bill in 2020 that would prohibit negative reporting during major disasters.[479]

Another approach could be to change reporting processes and data standards. For instance, consumers must currently reach out to each furnisher individually about disaster-related hardships, and furnishers are not required to forward the information to credit bureaus. Current data formats also do not capture the dates that special comment codes are added or removed; rather, once the lender stops reporting a code it disappears. Thus, subsequent credit report users are not notified of the hardship.[480]

C.2.2 Economic Downturns

In June 2020, FICO announced a new product called a "Resilience Index" that is designed for use in conjunction with traditional FICO scores to evaluate which consumers within any particular scoring band are likely to be relatively sensitive to or resilient in the face of economic downturns.[481] When it introduced an updated model in July 2022, FICO reported that about 200 financial institutions were using the index scores for loan originations, portfolio stress testing, and other purposes.[482]

The model was developed based on data from the 2008 financial crisis using variables that are derived from traditional consumer reports to determine which consumers' performance was better than average for their scoring cohorts. For example, consumers with longer experience managing credit, lower revolving and auto loan balances, and fewer active accounts tend to have fewer defaults relative to other consumers with the same credit score during downturns.[483]

A white paper commissioned by FICO concluded that the product could substantially increase access to credit during downturns in middle and low score bands by giving lenders a way to evaluate which consumers are less likely to default, rather than setting higher score cut offs across the board.[484] However, some consumer advocates have reacted with skepticism, raising concerns that lenders may use the new models to reject applicants rather than to expand credit access and that the models may tend to reflect and replicate racial disparities in income and assets.[485]

C.2.3 Medical Debts

Medical debts historically have had a substantial impact on consumers' credit reports, thanks both to the complexities of the U.S. healthcare system and inconsistent credit reporting practices.[486] CFPB studies have found that 50 to 60 percent of collections tradelines in consumer reports over the past decade relate to unpaid medical bills. A 2014 study by the CFPB found that half of consumers with medical debts showed no other serious delinquencies in their credit reports and that medical collections tradelines were less predictive of future delinquency than non-medical collections tradelines.[487]

In 2017, the three NCRAs reached settlements with 32 states in which they agreed not to include medical debts less than six months past due in consumers' reports and to remove debts that are paid by insurance.[488] Recent credit scoring models also reduce the weight placed on medical collections, although older models still dominate the market.[489]

The pandemic has focused further attention on medical debts' impact on credit scores, with several bills introduced in Congress to restrict reporting practices.[490] One bill that passed the House in May 2021 would prohibit reporting of debt arising from a medically necessary procedure, as well as generally delaying reporting of other unpaid medical debts for one year.[491] President Biden also announced that federal credit programs would stop using medical debt for underwriting purposes "whenever possible and consistent with the law."[492]

In summer 2022, the three NCRAs also announced that they would delay reporting unpaid medical debts until they are 12 months past due, remove medical collections items immediately upon payment, and in 2023 stop reporting medical debts below $500.[493] However, the CFPB is urging more changes after concluding that about half of consumers who have medical items on their reports are still likely to have some items reflected after the 2023 changes take effect.[494] VantageScore subsequently announced that it would adjust its 3.0 and 4.0 models to remove any consideration of medical items by mid-October 2022.[495]

C.3 Broader Debates and Longer-Term Initiatives

Many of the ideas about changes in credit reporting and scoring practices described above implicate broader policy debates about whether negative aspects of the current system are best addressed by withholding and restricting information flows or by further increasing them to facilitate more nuanced and consistent analyses. Proponents of suppressing negative information argue that it is a practical short-term strategy for reducing the risk that consumers' access to credit, insurance, housing, and employment are reduced by exogenous shocks or by mistakes or misconduct by lenders, servicers, or other industry actors that are beyond the borrowers' personal control.[496] Critics argue that withholding data from the consumer reporting system can be both logistically difficult—for example if it requires reprogramming by individual furnishers—and likely to have unintended consequences—for example if consumer report users increase their minimum requirements because they lose confidence in the validity of available data and scoring models.[497]

The CARES Act charted somewhat of a middle path by requiring that consumers' delinquency status remain static while they were complying with pandemic-related accommodations, as discussed in Section 4.1. It thus reduced the risk that consumers' scores would decline due to pandemic effects, although it did not withhold information altogether and depended on individual consumers obtaining accommodations from individual lenders. Some implementation problems occurred within the first few months after passage, and some news reports suggested that lenders were concerned about scoring distortions.[498] Over time, however, lenders gradually relaxed their criteria as economic conditions improved, many households paid down debts, and credit scores rose.[499]

Public empirical analyses of the effects of the CARES Act requirements on credit scores and model predictiveness are limited. Studies find evidence of positive effects on the scores of consumers who received forbearances, although some suggest that credit card deleveraging by a broader range of households may have had larger impacts on credit scores nationwide.[500] One credit bureau analysis found that borrowers who obtained forbearances in 2020 were not substantially more prone to delinquencies on new credit card accounts in 2021 than consumers who did not obtain forbearances, but little detailed research over longer time frames is publicly available.[501]

Looking ahead to creating the first generation of post-pandemic credit scoring and underwriting models, the ongoing debates about the downstream effects of financial shocks on credit reports and scores are fueling stakeholder interest in using additional data sources and models to provide more real-time, nuanced insight into household finances. One source of particular interest is cash-flow information from bank or other transaction accounts. Although incorporating such data is not easy given the complexity of existing systems and unsettled regulatory questions as discussed in Section 5.2, the hope is to develop systems that are both more predictive and inclusive to promote resiliency among borrowers and lenders alike.

GLOSSARY

Application programming interfaces (APIs): APIs are software-based communications protocols or functions between websites or applications, allowing them to exchange information and data using a common format. See Section 2.2.3.

Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA): This 2005 legislation tightened the eligibility and process requirements for consumer bankruptcy filings and further heightened barriers to discharging student loans. See Section 3.1.1.

Chapter 7 bankruptcy: Often called a liquidation, this option requires consumers to meet a means test and to surrender any assets that exceed exemption limits to be applied toward their debts. More than 90 percent of filers receive discharges of their debts, generally within six months. See Section 2.2.5.

Chapter 13 bankruptcy: Often called a wage earner's plan, this option may allow consumers to retain their homes and cars but generally requires them to pay all disposable income to reduce their debts over three to five years. Studies suggest that only about half of filers receive discharge of their debts under this option. See Section 2.2.5.

Charge off: This is an accounting action where lenders write loans off as a loss, although it does not affect consumers' obligations to pay the debt. Federal banking guidance requires that charge off occur after no more than 120 days' delinquency for installment loans and 180 days' delinquency for open-end loans. See Section 2.1.1 and Section 2.2.2.

Consumer Financial Protection Bureau (CFPB): The CFPB is a federal agency with authority to supervise, enforce, and write rules to implement certain federal consumer protection statutes, such as the Fair Debt Collections Practices Act and the Equal Credit Opportunity Act. Its supervision authority includes both large depository institutions and various categories of non-bank financial services providers.

Debt Management Plan (DMP): This is a multi-lender workout plan for unsecured credit that is typically administered by a nonprofit credit counseling agency. DMPs are generally structured to repay all principal after no more than 60 months, consistent with federal banking guidance. See Section 2.2.3 and Section 3.1.2.

Debt Settlement Company (DSC): Debt settlement companies are for-profit companies that seek less-than-full-balance settlements from lenders on consumers' behalf. The sector is growing rapidly but has attracted criticism because of its relatively high fees and business practices. See Section 2.2.4 and Section 3.1.3.

Federal Trade Commission (FTC): The Federal Trade Commission is a federal agency charged with protecting consumers and competition by preventing anticompetitive, deceptive, and unfair business practices. It oversees implementation of the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. §§ 6101-6108, including regulations that specifically govern debt settlement companies, and the Credit Repair Organizations Act, 15 U.S.C. §§ 1679 et seq. The FTC shares enforcement authority over many non-bank financial services providers with the Consumer Financial Protection Bureau.

Less-Than-Full-Balance plans (LTFB): Less-than-full-balance repayment plans are not structured to repay all principal. They have a negative effect on some credit scoring models. See Section 2.2.2 and Section 2.2.4.

Nationwide Consumer Reporting Agency (NCRA): These are credit bureaus that compile consumer records on a nationwide basis. The files of three specific NCRAs—Equifax, Experian, and TransUnion—are used as the basis for third-party credit scoring models developed by companies such as FICO and VantageScore. See Appendix C.

Re-aging: In the context of this report, this refers to a lender practice that is designed to help consumers overcome temporary financial difficulties by returning an account to current status before all overdue amounts have been repaid. Federal banking guidance sets eligibility requirements and limits the number of re-ages that can occur within specified time periods. See Section 2.1.1 and Section 2.2.2.

Risk-based pricing: Risk-based pricing is a system by which lenders charge higher prices to borrowers that are deemed to be at higher risk of default to cover the increased risk of losses. Proponents argue that it increases access to credit for applicants who might otherwise be denied, while critics argue that it makes it less likely that financially vulnerable applicants will be able to repay their loans. See Section 2.1.3.

Utilization rates: This refers to a metric used in many credit scoring models that considers how much credit borrowers are using on revolving accounts, such as credit cards, or certain other types of credit. Higher utilization rates are generally associated with greater risks of delinquency. See Section 2.1.3 and Appendix C.

Workout plan: This term is sometimes used to refer to repayment plan structures that are designed to repay all principal over time. See Section 2.2.1.

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120 Andrew Haughwout et al., Home Prices, Housing Wealth and Home Equity Extraction, Federal Reserve Bank of New York 34-36 (May 17, 2018); Diana Farrell et al., Tapping Home Equity: Income and Spending Trends Around Cash-Out Refinances and HELOCs, JPMorgan Chase Institute 6 (2020).

121 Haughwout et al. (2018) at 40-41.

122 Chava et al. (2021); J. Christina Wang, Technology, the Nature of Information, and FinTech Marketplace Lending, Current Policy Perspectives 18-3, Federal Reserve Bank of Boston 6 (2018) (between 60 percent and 80 percent depending on the year); Robert M. Adams, Do Marketplace Lending Platforms Offer Lower Rates to Consumers?, FEDS Notes (Oct. 2018) (77 percent).

123 Adams (2018); Chava et al. (2021). See also Marco Di Maggio & Vincent Yao, Fintech Borrowers: Lax-Screening or Cream-Skimming, 34 Rev. of Financial Studies 4565 (2021) (finding that consumers who borrow from a range of fintech lenders including marketplace platforms tend to have FICO scores between 640 and 720). Studies of offers for personal loans find that marketplace lenders are more likely to reach out to consumers with near prime and subprime scores, bankruptcies, or recent denials of previous credit applications than banks, but that other types of non-banks concentrate more intensely on consumers with subprime scores. Erik Dolson & Julapa Jagtiani, Which Lenders Are More Likely to Reach Out to Underserved Consumers: Banks Versus Fintechs Versus Other Nonbanks?, Consumer Finance Institute Working Paper 21-17, Federal Reserve Bank of Philadelphia (2021).

124 Julapa Jagtiani & Catharine Lemieux, The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub Consumer Platform, 48 Financial Management 1009 (2019); Robert Adams, Do Marketplace Lending Platforms Offer Lower Rates to Consumers?, FEDS Notes (Oct. 22, 2018). See also Dolson & Jagtiani (2021) at 22 (analyzing the range of interest rates in marketplace and bank credit solicitations).

125 Chava et al. (2021). Similar borrowers who took out bank installment loans also showed a substantial differential of 25 percent between those who used all proceeds for consolidation and those who used none for that purpose. At least one marketplace lender has created a program under which it delivers loan proceeds directly to the borrowers' previous lenders in return for a discounted price. Kevin Wack, New LendingClub Feature Lets Customers Pay Off Card Debt Directly, American Banker (June 18, 2019).

126 Timothy Dore & Traci Mach, Marketplace Lending and Consumer Outcomes: Evidence from Prosper, 54 Applied Economics 390 (2022) (comparing outcomes between marketplace borrowers and applicants who decided not to take out the loans); Hongchang Wang & Eric M. Overby, How Does Online Lending Influence Bankruptcy Filings?, 68 Management Science 3309 (2022) (comparing bankruptcy filings in states after marketplace lenders obtained licenses to operate there); Chava et al. (2021) (comparing marketplace borrowers to consumers who sought installment loans from banks); Tetyana Balyuk, FinTech Lending and Bank Credit Access for Consumers, Management Science Articles in Advance (2022). (analyzing outcomes for consumers who borrowed multiple times from the same marketplace lender). Compare Di Maggio & Yao (2021) (analyzing outcomes from a broader range of fintech lenders not limited to those who provide consolidation loans to outcomes for a broad set of non-fintech lenders).

127 Nearly all U.S. credit card issuers are banks.

128 See David Rowell & Luke B. Connelly, A History of the Term "Moral Hazard," 79 J. of Risk & Insurance 1051 (2012), for a discussion of the ways that different stakeholders use the term.

129 Governments' responses to the 2008 financial crisis have sparked a wide literature on moral hazards for lenders, for example. See, e.g., Amir Sufi & Alan M. Taylor, Financial Crises: A Survey, University of Chicago Becker Friedman Institute Working Paper No. 2021-97 (Aug. 2021); Allen N. Berger et al., Did TARP Reduce or Increase Systemic Risk? The Effects of Government Aid on Financial System Stability, 43 J. of Financial Intermediation No. 100810 (2020); John Crawford, The Moral Hazard Paradox of Financial Safety Nets, 69 Cornell J. of Law & Public Policy 95 (2015); Lamont K. Black & Lieu N. Hazelwood, The Effect of TARP on Bank Risk-Taking, 9 J. of Financial Stability 790 (2013). Some commentators have also raised concerns that income-based repayment plans and debt forgiveness programs reduce incentives for institutions of higher education to contain their costs. See, e.g., Stein (2003). See Section 3.1.2 and Section 3.2.2 on mortgage and student loan relief efforts.

130 See, e.g., Diana Farrell et al., Mortgage Modifications after the Great Recession: New Evidence and Implications for Policy, JPMorgan Chase Institute (2017); Peter Ganong & Pascal J. Noel, Why Do Borrowers Default on Mortgages? A New Method For Causal Attribution, Working Paper 2020-100, Becker Friedman Institute for Economics at the University of Chicago (2020); Sauro Mocetti & Eliana Viviano, Looking Behind Mortgage Delinquencies, Temi di Discussione (Working Papers) 999, Bank of Italy (2015); Kristopher S. Gerardi et al., Unemployment, Negative Equity, and Strategic Default, SSRN Electronic Journal (2013). For analyses relating to strategic default concerns in unsecured lending, see, e.g., Hui Wang & Mario J. Miranda, A Heterogeneous Agent Model of Strategic Credit Card Default over the Business Cycle (2015); Scott Fulford & Scott Schuh, Credit Cards, Credit Utilization, and Consumption, Economics Faculty Working Papers Series, West Virginia University (2020).

131 David Low, What Triggers Mortgage Default? New Evidence from Linked Administrative and Survey Data, CFPB Office of Research Working Paper 2022-02, Consumer Financial Protection Bureau (2022).

132 John M. Griffin et al., Did FinTech Lenders Facilitate PPP Fraud?, J. of Finance (forthcoming) (2022); Kurt R. Erskine et al., President Biden Extends Statute of Limitations for PPP and EIDL Fraud to Ten Years, 12 National Law Review (Sept. 6, 2022); Cezary Podkul, How Unemployment Insurance Fraud Exploded During the Pandemic, ProPublica (July 26, 2021); Pandemic Response Accountability Committee, Pandemic Unemployment Insurance: How Much Has Been Paid to Fraudsters?, Pandemic Oversight.

133 Susan Cherry et al., Government and Private Household Debt Relief during COVID-19, Brookings Papers on Economic Activity 157 (Fall 2021).

134 CFPB 2021 Credit Card Report at 141-142.

135 CFPB 2021 Credit Card Report at 140 (surveyed card issuers assessed both borrowers' ability and willingness to pay, including documenting the reason, severity, and duration of the cardholders' financial difficulties).

136 Melissa Lambarena, What Is a Credit Card Hardship Program?, NerdWallet (Oct. 2, 2020).

137 For background on supervision, see FinRegLab 2020 Cash-Flow Report at 39.

138 65 Fed. Reg. 36903, 36905 (June 12, 2000); Office of the Comptroller of the Currency et al., Account Management & Loss Allowance Guidance, OCC Bulletin 2003-1, at 4 (2003). For a discussion of the potential tensions between transparency and adequate loss reserves, see Eliana Balla et al., Loan Loss Reserve Accounting and Bank Behavior, Economic Brief 12-03, Federal Reserve Bank of Richmond (2012).

139 65 Fed. Reg. at 36904-05. Guidance for credit unions is somewhat more flexible. The guidance indicates that charge-off policies should target loans where a "high probability of loss" exists, though examples of such loans in the guidance largely give similar timelines as bank guidance. National Credit Union Administration, Loan Charge-off Guidance (03-CU-01) (Jan. 2003).

140 Balla et al. (2012).

141 65 Fed. Reg. at 36905-06. For open-end loans, for example, the borrower must make at least three consecutive minimum monthly payments or an equivalent lump sum payment, and banks are not allowed to advance funds to cover those payments.

142 Office of the Comptroller of the Currency, Comptroller's Handbook: Safety and Soundness: Credit Card Lending Version 2.0 at 45 (April 2021). Workouts are defined as programs where issuers close a borrower's account and convert it into an installment debt, including temporary hardship programs that last more than 12 months.

143 65 Fed. Reg. at 36905-06

144 Office of the Comptroller of the Currency (2021); CFPB 2021 Credit Card Report.

145 Financial consequences at the organization level can include increased losses or reserves, which may in turn affect staff compensation.

146 Office of the Comptroller of the Currency (2021) at 42 n.60.

147 Some stakeholders contrasted general unsecured lending with mortgage markets, where lenders and servicers typically use a "net present value" test to determine whether it is more cost effective to modify a loan than to foreclose. While lenders may or may not be willing to forbear or forgive principal, the analysis creates a relatively standardized way to evaluate potential resolution options given that foreclosure involves certain costs and risks. See Section 3.2.1. In the absence of such a benchmark for general unsecured loans, lenders may be concerned that wide variations in concessions could raise concerns among safety and soundness regulators or under fair lending laws and prohibitions on unfair, deceptive, or abusive acts and practices. See FinRegLab 2020 Cash-Flow Report at 14, 82 for general descriptions of those laws.

148 CFPB 2021 Credit Card Report at 143.

149 Another option might be to take a hybrid approach by charging off the forgiven amount and holding reserves against the balance as an impaired debt, but stakeholders were divided over whether that structure would be permissible and indicated that it would likely require reprogramming or manual overrides of accounting and credit reporting systems.

150 CFPB 2021 Credit Card Report at 139-140.

151 The IRS considers a consumer insolvent if the fair value of all their assets does not exceed their liabilities immediately before debt cancellation. Internal Revenue Service, Canceled Debts, Foreclosures, Repossessions, and Abandonments (for Individuals), Publication 4681 (Feb. 16, 2022).

152 Wilshusen (2011); FinRegLab, Research Brief, Covid-19 Credit Reporting & Scoring Update (July 2020).

153 CFPB, Recent Trends (2020) at 2, 6.

154 CFPB, Recent Trends (2020) at 8. See Section 2.2.4.

155 CFPB 2021 Credit Card Report at 139. Although the respondent issuers had generally been trending away from offering distinct short-term forbearance programs prior to the pandemic, the most recent survey conducted in 2020 shows that they have since reversed course as discussed further in Section 4.1.

156 CFPB 2021 Credit Card Report at 140; CFPB, Recent Trends (2020); CFPB 2019 Credit Card Report.

157 CFPB 2021 Credit Card Report at 142; CFPB 2019 Credit Card Report at 151-152. Pre-charge-off settlements tend to be slightly higher, ranging from 51 to 53 percent of balances owed depending on the time period.

158 CFPB 2021 Credit Card Report at 142.

159 Some lenders will only work with nonprofit agencies or may refuse to work with a particular agency if there are concerns about its management.

160 The monthly payment amounts and level of concessions can vary significantly depending on the lender and tiering thresholds. For instance, monthly payments for consumers in the most distressed tier may be in the range of 1.75 percent of total balance plus 2 percent APR, while payments for the least distressed tier may exceed 2 percent of total balance plus APRs above 10 percent.

161 Washington Center for Equitable Growth, Issue Brief: Alleviating Financial Distress and Its Economic Consequences in the United States (2017).

162 Daniel T. Brown et al., The Success and Failure of Counseling Agency Debt Repayment Plans, 38 Eastern Economic J. 1, 99-102 (2012); Wilshusen (2011) at 6; Robert M. Hunt, Whither Consumer Credit Counseling?, Federal Reserve Bank of Philadelphia Business Review Q4 at 11-13, (Q4 2005); National Consumer Law Center, Credit Card Debt and Credit Counseling, Consumer Concerns 2-3 (2011). See Section 2.2.2, Box 4 for additional background on lender accounting processes.

163 It is also unclear how closely creditors screen new applicants to determine whether they are participating in a DMP. As noted below, some lenders do not report whether an account is enrolled in a DMP to credit bureaus.

164 See Section 3.1.4 regarding federal requirements for credit card statements.

165 Jonathan Pompan, A Legal Issues Primer for Credit Counseling Agencies, Debt Management Plan Providers, and Debt Settlement Companies, Venable (2008); Jonathan L. Pompan, Debt Relief Services Back in the Spotlight, All About Advertising Law, Venable (2020); Jeffrey S. Tenenbaum & Jonathan L. Pompan, Hot Legal Topics for Credit Counseling Agencies: A Legal and Regulatory Update, Venable (2009); see also Jonathan L. Pompan, Debt Services Advertising: Major Search Engine to Require BK Counseling Approval and Certification, Venable (2019) (describing Google restrictions on advertising about debt management and debt settlement services).

166 Wilshusen (2011) at 6-7. Some counseling agencies use $25 per month as a recommended amount for savings.

167 For a more detailed discussion of APIs, see FinRegLab 2020 Cash-Flow Report § 4.2.2.

168 Certain state regulations may mandate a particular format for credit counseling depending on the type of debt involved (e.g., in Massachusetts, CCAs are required to have face-to-face meetings for reverse mortgage counseling with elderly clients). Federal agencies also encourage face-to-face counseling in connection with reverse mortgages. U.S. Department of Urban Housing and Development, HECM Protocol (visited Sept. 15, 2022).

169 See Appendix A for discussion of research on the efficacy of credit counseling separate from DMP enrollment.

170 Some lenders penalize counseling agencies if consumers enroll but do not actually begin payments, so counseling agencies may wait to submit final documentation until the first payment is made. Stakeholders report that the finalization process can create some uncertainty for consumers, both because they may still receive collections calls while paperwork is pending and because eligibility determinations may change if the amount due on the accumulated debt turns out to have been higher than expected. While some lenders have automated systems for approving DMPs, others do not. At least one vendor has launched a digital platform to facilitate improved communications between counseling agencies and lenders. See Peregrin, https://www.peregrin.com.

171 26 U.S.C. § 501(q)(B), (C); Kim Porter, What You Need to Know About Debt Management Plans, Bankrate (Aug. 19, 2021); Mark Henricks & Daphne Foreman, Forbes Advisor (June 3, 2021).

172 A Debt Management Plan: Is It Right for You?, Ask Experian (visited Sept. 15, 2022).

173 Wilshusen (2011) at 9.

174 CFPB, Recent Trends (2020) at 2, 6-7. CFPB surveys of large credit card issuers indicate that enrollments in internal forbearance programs and debt management plans began to increase in 2017-2018, although they remained below two percent of total pre-charge-off delinquent balances and the reports do not distinguish between the two categories. CFPB 2021 Credit Card Report; CFPB 2019 Credit Card Report; Consumer Financial Protection Bureau, The Consumer Credit Card Market (2017).

175 NFCC has about 50 affiliate members. The Financial Counseling Association of America (FCAA), formerly known as the Association of Independent Consumer Credit Counseling Agencies, is a second nonprofit membership organization with some overlap in members with the NFCC. About 10 percent of nonprofit counseling agencies are not affiliated with either group. Adrienne DiTommaso & Stephanie Moulton, Credit Counseling and Long-Term Credit Outcomes: Evidence from the National Foundation for Credit Counseling's Sharpen Your Financial Focus Program 3 (2022).

176 DiTommaso & Moulton (2022); John M. Barron & Michael E. Staten, DMP Participation and Credit Counseling Outcomes (2011). The studies defined DMP enrollment as having made at least one payment on a DMP. Barron and Staten found some consumers who were not initially recommended for a DMP by the participating agency, but later enrolled in one anyway.

177 DiTommaso & Moulton (2022); Barron & Staten (2011). Barron and Staten perform a multivariate analysis of data from consumers counseled in 2007; holding other factors equal, they find counseled consumers who enroll in DMPs are likely to have higher utilization rates on revolving credit but lower debt balances. Credit score was not statistically significant as between the two populations. Patterns were generally similar when comparing consumers who enrolled in DMPs to consumers who were eligible but did not enroll. DiTommaso and Moulton analyze averages for consumers counseled between 2013 and 2016, finding that consumers who enrolled in DMPs had average higher credit scores and larger loan balances on all categories except derogatory debt than counseled consumers who did not enroll.

178 Barron & Staten (2011) at 4, 11-13, 16-17. Note that the study period included the worst part of the 2008 financial crisis. After controlling for balances and various other characteristics, the study concluded that DMP participation reduced the likelihood of bankruptcy filing by about 12 percent. Barron & Staten (2011) at 12, 14.

179 DiTommaso & Moulton (2022).

180 The matches were performed using credit bureau data, without being able to directly observe income, savings/assets, job loss, expense shocks, or motivation. Although all of the cohorts showed signs of increasing distress in the year before the counseling date, metrics for the percent of consumers who had experienced delinquencies over the past 12 months and who had experienced charge offs increased more rapidly for counseled consumers than for the comparison groups in the year *after* counseling. This could indicate the present of additional incremental hardships that members of the comparison group did not experience. In addition, people who seek counseling are signaling motivation to obtain relief from their debt that members of the comparison group may not share. DiTommaso & Moulton at 9, 22-26 (2022).

181 DiTommaso & Moulton (2022).

182 See, e.g., Barron & Staten (2011) at 20-21 (amount of total debt repaid tended to be lower for participants with lower credit scores, worse credit indicators at the time of counseling, and larger households); Brown et al. (2012) at 107-108 (analyzing income, assets, liabilities, expenses, and a range of credit report factors).

183 Barron & Staten (2011) at 23-24 (holding composite interest rates on DMP-enrolled debt constant), higher original interest rates were associated with higher repayment levels); Brown et al. (2012) at 107-108 (holding other factors equal, a ten-percentage point increase in the original composite interest rate was associated with a 4.7 percent increase in the amount of debt repaid, and a 10-percentage point increase in the DMP composite interest rate was associated with a 5.4 percent decrease in payment).

184 Brown et al. (2012) at 107-108.

185 Will Dobbie & Jae Song, Targeted Debt Relief and the Origins of Financial Distress: Experimental Evidence from Distressed Credit Card Borrowers, 110 American Economic Review 984 (2020). The credit counseling agency was Money Management International.

186 Dobbie & Song (2020) at 990. Among control group members, the average minimum monthly payment was $440 (2.38 percent of their original balance), the average interest rate was 9.90 percent, and the average plan length was 52 months. Dobbie & Song (2020) at 989.

187 Dobbie & Song (2020) at 985-992. For instance, one lender that offered the most generous interest write-downs did not offer any minimum payment reductions, while others offered a combination of concessions. The two lenders that offered the most generous minimum payment reductions offered the smallest level of interest write-downs relative to the control group. Overall, there were about 50,000 unique combinations of potential write-downs and payment reductions in the sample. Dobbie & Song (2020) at 998-999, Online Appendix Table A3. The median treatment group interest write-down was $1,712 larger than the control group, while the median treatment group monthly payment was $26 per month less; the treatment group plans lasted an average of four months longer than the plans in the control group.

188 If applied to the average debt in the control group, the most generous interest rate reductions would have ended the payment plan 10 months early and saved the consumer an additional $4,300, while the most generous payment reductions would have reduced monthly payments by about 20 percent but extended the plan length by 18 months and increased total interest paid by $1,600. The study authors calculate that the net present cost to lenders of these two concession structures is equivalent at a discount rate of 16.4 percent, with the rate reduction being more expensive at lower discount rates and the payment reduction being more expensive at higher discount rates. Dobbie & Song (2020) at 992-993, Online Appendix Figure A2.

189 Dobbie & Song (2020) at 987, 1003-1007, 1015-1016. The analysis concluded that reducing the length of payment plans for participants who received the maximum interest write-downs was responsible for only about 15 percent of the improved indicators, and that the larger impact for that intervention was due to the strong incentives for participation it created early in the program prior to the actual balance reductions. Dobbie & Song (2020) at 1015-1016.

190 Dobbie & Song (2020) at 989, Online Appendix Table A1.

191 Greg J. Regan, Options for Consumers in Crisis: An Economic Analysis of the Debt Settlement Industry (Fourth Edition), American Fair Credit Council 6, 24-29 (2021). See also Will S. Dobbie, Financial Outcomes for Debt Settlement Programs: Estimates for 2011-2020 at 3 (2021); Leslie Parrish, A Roll of the Dice: Debt Settlement Still a Risky Strategy for Debt-Burdened Households, 18 Cityscape 2 (2016).

192 Regan (2021) at 8 (reporting quarterly enrollments for several large national DSCs); United States Courts, Annual Bankruptcy Filings Fall 29.7 Percent (Jan. 28, 2021); CFPB 2019 Credit Card Report at 166-167; CFPB 2021 Credit Card Report at 143-144; CFPB, Recent Trends (2020) at 2, 6.

193 Dobbie (2021).

194 In 2019, Google restricted advertising relating to debt management and debt settlement services to only those entities that it certifies. Pompan (2019).

195 Under the Fair Credit Reporting Act, lenders are permitted to purchase the names and addresses of consumers who meet their "pre-screening" criteria from credit bureaus, so long as they make those consumers a "firm offer of credit," meaning that the lender is generally required to honor the offer unless the consumer's credit profile changes substantially by the time they follow up about the loan. Although stakeholders are divided about whether debt settlement services fit within this provision, news reports and lawsuits suggest that some DSCs historically purchased information from credit bureaus or partnered with debt consolidation lenders that frequently rejected applicants who followed up on prescreened offers and instead cross-marketed DSC services. Some credit bureaus have changed their practices. Jean Eaglesham & AnnaMaria Andriotis, That Offer to Make You Debt Free? It Can Make You Worse Off, Wall St. J. (Aug. 10, 2019); see also Consumer Financial Protection Bureau, Consumer Financial Protection Bureau Settles with Monster Loans, Thomas Chou, Sean Cowell, and Related Companies (May 14, 2020) (involving student loan debt-relief companies); Seventh Circuit Consumer Law Digest, 7th Circuit: Spokeo Dooms FCRA 1681b Claim (Feb. 20, 2020) (involving litigation against credit bureaus for selling information to debt settlement companies).

196 Some debt settlement companies use face-to-face meetings involving attorneys or paralegals to attempt to avoid certain federal legal restrictions on advance fees. See Parrish (2016) at 58, Section 3.1.3.

197 Federal law prohibits non-profit credit counseling agencies from paying or receiving referral fees, and state laws and ethical restrictions may limit fees and/or require disclosures in particular circumstances involving attorneys. However, compensation for referrals among various parties in connection with debt settlement activity has historically been a controversial practice. See, e.g., 26 U.S.C. § 501(q)(1)(F); Cal. Civ. Code § 1788.302; New York City Bar, Profiteering from Financial Distress: An Examination of the Debt Settlement Industry (2012).

198 BSI, AFCC Best Practices Checklist version 12 at 9 (July 2022) (prohibiting members' policies and procedures for dealing with creditors from "the use of cease and desist notices sent to creditors or advising customers to notify creditors of changes of address or phone numbers meant to divert communication from the creditor to the debt settlement provider rather than the customer"); American Fair Credit Council, Homepage (explaining AFCC's use of BSI in its standards and certifications functions); Consumer Financial Protection Bureau, Evolutions in Consumer Debt Relief Event, Session 5 Transcript: Future of Debt Relief: Emerging Opportunities & Challenges (Mar. 2020).

199 Dobbie (2021) at 2.

200 Regan (2021) at 35-38.

201 Within the first six months of origination, the report indicates that borrowers' credit scores rose by an average of 64 points, started from a weighted average of 564. Regan (2021) at 37-38..

202 CFPB 2021 Credit Card Report at 153.

203 CFPB 2021 Credit Card Report at 143-144; CFPB 2019 Credit Card Report at 166-167.

204 16 C.F.R. § 310.4(a)(5)(i); Mitch Strohm, Best Debt Settlement Companies of October 2022, Forbes Advisor (Oct. 5, 2022).

205 The IRS considers a consumer insolvent if the fair value of all their assets does not exceed their liabilities immediately before debt cancellation. Internal Revenue Service (2022).

206 CFPB 2019 Credit Card Report at 167.

207 CFPB 2021 Credit Card Report at 143-144.

208 Participating companies are required to adhere to the American Fair Finance Council's code of conduct and FTC rules prohibiting up-front charges, which took effect shortly before January 1, 2011. The data have been released via a series of reports from 2013 to 2021 by Greg J. Regan, a forensic accountant, in what are commonly known as the Regan Reports. Harvard professor Will S. Dobbie has issued two reports reviewing elements of the Regan Reports' methodology and conducted additional analyses using some of the same data. Dobbie (2021); Will S. Dobbie, Financial Outcomes for Debt Settlement Programs (2020).

209 Regan (2021); Dobbie (2021) at 3. The participants enrolled an average of 7.3 accounts and an average of $28,250 in balances.

210 Regan (2021) at 24-25; Greg J. Regan, Options for Consumers in Crisis: An Economic Analysis of the Debt Settlement Industry (Third Edition), American Fair Credit Council 21 (2018). See also Consumer Financial Protection Bureau, Evolutions in Consumer Debt Relief Event, Session 4 Transcript: Consumer Journeys Through Debt Relief (Mar. 2020) (stating that about 20 percent of consumers who contact DSCs enroll, but that some decide against enrollment because of disclosures rather than eligibility denials).

211 Regan (2021) at 24-25; Regan (2018) at 21.

212 The report concludes that debt settlement is a better option for consumers than continuing to make minimum monthly credit card payments for the same period, assuming a 16 percent interest rate or higher, and that accretion rates generally fall below the level for minimum credit card payments once a consumer has settled two accounts. Regan (2021) at 25-29. A second analysis focusing on consumers with at least 36 months of account history with DSCs found that the annualized accretion rate for enrolled debt was more than 25 percent in the first few months after enrollment, but dropped to less than 10 percent after 18 months. The author concluded that

consumers would have lower debt levels after enrolling in a debt settlement program compared to making minimum required payments on their credit cards, but also stated that the calculations assumed that individuals who enrolled in debt settlement programs could not in fact make their minimum required payments. Dobbie (2021) at 5.

213 Regan (2021) at 3, 19.

214 Dobbie (2021). Regression analyses found that post-enrollment outcomes were generally more positive as account balances increased up to a threshold of about $5,000 and as consumers' total enrolled debts increased up to a threshold of about $40,000.

215 Regan (2021) at 22-23. Among the term settlements, 74 percent had been completed as of the time of the study date, while seven percent had been broken and 19 percent were still active. Among the broken settlements, about 95 percent were renegotiated, while the remainder were subject to legal proceedings or listed as "other."

216 Regan (2021) at 2, 3-4, 21-22.

217 Dobbie (2021) at 4.

218 Frederick Huynh, Debt Settlement and Bankruptcy: A Comparison of Credit Scores, Freedom Debt Relief (2022); Will S. Dobbie & Frederick Huynh, A Descriptive Comparison of Chapter 13 Bankruptcy and Debt Settlement (2021); Freddie Huynh, Blog, Debt Settlement and the Road Back to FICO Score Recovery, Freedom Debt Relief (Sept. 15, 2020); Freddie Huynh, Blog, Reduced Debt Burden — The Proof is in the Pudding (Sept. 29, 2020).

219 The report notes that the median credit scores for consumers who enrolled in Freedom programs after mid-2017 have been substantially lower than for the 2014-2015 cohort, which it attributes to more rigorous screening criteria. Hunh (2022).

220 An earlier Freedom Financial data also highlighted poor outcomes for some consumers in Chapter 13 bankruptcy, estimating that they experienced net losses after filing as compared to most debt settlement customers and more successful Chapter 13 filers. Dobbie & Huynh (2021).

221 American Bankruptcy Institute, Quarterly Non-business Filings by Chapter, 1994 to Present (visited Sept. 15, 2022); Angela Littwin, The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for Its Surprising Success, 52 William & Mary L. Rev. 1933 (2011). About a tenth of one percent of personal filings occur under Chapter 11, which is more typically used to reorganize businesses. American Bankruptcy Institute (2022).

222 11 U.S.C. §§ 109(h), 111. See Section 3.1.1 for further discussion of BAPCPA.

223 Dalié Jiménez et al., Improving the Lives of Individuals in Financial Distress Using a Randomized Control Trial: A Research and Clinical Approach, 20 Georgetown J. on Poverty L. & Policy 449, 452-453 (2013). See Section 3.1.1 for further discussion of BAPCPA.

224 United States Courts, Chapter 7 – Bankruptcy Basics & Chapter 13 – Bankruptcy Basics (visited Sept. 15, 2022).

225 Debt.org, The Cost of Bankruptcy (visited Sept. 15, 2022)

226 The average gross monthly income (AGMI) is calculated for the six months prior to filing and adjusted for family size. Carlos Parra, How Does Consumer Bankruptcy Protection Impact Household Outcomes? (July 15, 2022).

227 See Section 3.1.1 for discussion of shifts in filing patterns over time.

228 Edward R. Morrison & Antoine Uettwiller, Consumer Bankruptcy Pathologies, 173 J. of Institutional & Theoretical Economics 174 (2017); Julapa Jagtiani & Wenli Li, Credit Access After Consumer Bankruptcy Filing: New Evidence, 89 American Bankruptcy J. 327 (2015).

229 Felipe Severino & Meta Brown, Personal Bankruptcy Protection and Household Debt 11 (2020); Adrien Auclert et al., Macroeconomic Effects of Debt Relief: Consumer Bankruptcy Protections in the Great Recession, NBER Working Paper 25685 at 9 (Mar. 2019); Lars John Lefgren et al., Chapter 7 or 13: Are Client or Lawyer Interests Paramount?, 10 Berkeley Electronic J. of Economic Analysis & Policy Advances 1, 5 (2010).

230 Sara S. Greene et al., Cracking the Code: An Empirical Analysis of Consumer Bankruptcy Outcomes, 101 Minn. L. Rev. 1031, 1083-1084 (2017). Some bankruptcy filers may use the Chapter 13 process to take advantage of the automatic stay on mortgage payments and pay outstanding arrears rather than obtaining a debt discharge. Morrison & Uettwiller (2017). In their survey of consumer bankruptcy filings in Cook County, Illinois between 2011 and 2015, Morrison and Uettwiller find that nearly 60 percent of filers had auto debt with an average of about $15,000.

231 11 U.S.C. §§ 111, 727; 15 U.S.C. § 1681c.

232 Lefgren et al. (2010) at 4, 5, 12 & n.28; Paul Kiel & Hannah Fresques, How the Bankruptcy System Is Failing Black Americans, ProPublica (Sept. 27, 2017); Robert M. Lawless & Angela Littwin, Local Legal Culture from R2D2 to Big Data, 96 Tex. L. Rev. 1352 (2018).

233 Will Dobbie et al., Consumer Bankruptcy and Financial Health, 99 Rev. of Economics & Statistics 853, 856 (2017); Jacelly C. Cespedes et al., The Effect of Principal Reduction on Household Distress: Evidence from Mortgage Cramdown, NBER Working Paper 28900, at 7 (June 2021); Greene et al. (2017) at 1051-1052, 1089.

234 Jagtiani & Li (2015); Greene et al. (2017); Edward R. Morrison et al., Race and Bankruptcy: Explaining Racial Disparities in Consumer Bankruptcy, 63 J. of Law & Economics 269 (2020). Some jurisdictions seize vehicles or suspend drivers licenses due to unpaid tickets, which may put additional pressure on the finances of distressed borrowers who rely on their cars to commute to work and live in areas lacking adequate public transportation. See below for more discussion.

235 11 U.S.C. § 109(e). Individuals who exceed the thresholds can file under Chapter 11, but such filings are rare. See n. 235.

236 Morrison & Uettwiller (2017).

237 The so-called feasibility standard requires that a bankruptcy plan be feasible, i.e., the consumer will be able to make all payments and comply with the plan in order to be confirmed. Critics argue that the standard is not sufficiently enforced given how few consumers obtain Chapter 13 discharges. Greene et al. (2017) at 1092.

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311 12 C.F.R. § 1026.7. The toll-free numbers are required to provide information about credit counseling and debt management services as well as referrals to U.S. bankruptcy trustee approved nonprofit credit counseling agencies.

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