

Exhibit E - *The Consumer Bankruptcy Reform Act: Seeking Fair and Practical Solutions to Consumer Bankruptcy Crisis*, Hearing on S. 1301 before Senate Judiciary Comm., 105<sup>th</sup> Cong., 2d Sess. 28-34 (1998)

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THE CONSUMER BANKRUPTCY REFORM ACT:  
SEEKING FAIR AND PRACTICAL SOLUTIONS  
TO THE CONSUMER BANKRUPTCY CRISIS

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HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT  
AND THE COURTS

OF THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

**S. 1301**

A BILL TO AMEND TITLE 11, UNITED STATES CODE, TO PROVIDE FOR  
CONSUMER PROTECTION, AND FOR OTHER PURPOSES

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## Comment

First, under current law, section 707 only applies in chapter 7 cases, not in chapter 13 cases. (See 11 U.S.C. sec. 103(b)). Second, we assume that the reference to the 16th day is a typographical error and that it was intended to be the 46th day. Third, under current law, section 521 has no paragraphs (7) or (8). The judges preparing this analysis have been unable to find any proposed amendment in H.R. 2500 that would add such paragraphs.

On a more substantive note, section 211 also provides that the dismissal will occur "without the need for any order of court." We believe that this provision for dismissal without court order is unwise from an administrative standpoint. Without a court order, at least one entered by a clerk, the status of a case will be ambiguous, delays in case closings may occur, and statistics may be skewed. If it is considered appropriate to dispense with prior notice to the debtor under these circumstances, it should be adequate to specify that the dismissal will be without notice and hearing or to permit the clerk to issue the dismissal. The dismissal could be made effective retroactively as of the 46th day.

Senator GRASSLEY. Professor Hira.

## STATEMENT OF TAHIRA K. HIRA

Ms. HIRA. Mr. Chairman, Senators Durbin and Kohl, and the distinguished panel, my remarks are based on a summary of 200 responses of the debtors who are in bankruptcy and the studies underway at ISU that are still being collected. This is an effort to know the people behind these large numbers of bankruptcies.

No single factor is sufficiently powerful to explain increasing numbers of bankruptcies in this booming economy. The environment in which this is happening is created by actions of many players, including borrowers, lenders, retailers, lawyers, parents, educators, and policymakers. In this environment, most bankruptcies are caused because people have too much debt, as we say. That may be a result of not knowing how to handle the debt, debt as a result of divorce and child support problems, medical bills, gambling, or compulsive buying.

Over the years, we have made a shift from debt to credit, and I will let you understand the importance of that difference. Our attitudes toward lending and marketing are aggressive. Our attitudes toward borrowing and filing bankruptcy are casual. In this environment, filing bankruptcy makes economic sense. It is easy, it is quick and simple. It provides relief from debt. It provides relief from creditors' calls and gives a chance to start all over.

Researchers have established that all families who could economically benefit from filing bankruptcy do not file. If they would file, numbers will be much larger. Dynamics of debtors' decisions to file bankruptcy are far more complex than economic utility. Most people file bankruptcy because they are unable to communicate with creditors to renegotiate payment terms to bring them under their control. They can't cope with the stress of collectors' calls. This is the most frequently mentioned reason why they file bankruptcy.

Most debtors live with this situation for one to two years before actually filing bankruptcy. The majority indicated their financial difficulties were affecting their family life, their performance at work, their emotional and physical health. Slightly over one-third tried to solve their problems through credit counseling before filing bankruptcy.

Most debtors learn about bankruptcy from those who have already filed; that is, their friends, their family members, and their

coworkers. There is an increasing number of them around them. They learn from attorney advertisements. Our respondents mentioned there are hotlines and there are free consultations available for them. Lawyers have significant influence on debtors' decision to file, when to file, and under what chapter to file. However, many respondents indicated they chose to file under chapter 13 because, "we wanted to pay back debts we owed and chapter 13 provided an honorable way out of a very difficult situation."

The profile of a debtor in bankruptcy over 20 years of my involvement has significantly changed. Debtors in bankruptcy now represent middle America, men and women alike. They are employed. They represent a wide area of occupations. They are married. They are in their late 30's or early 40's. Mean take-home pay in our sample was over \$28,000, mean debt over \$35,000, monthly payments on an average \$1,327. They had, on an average, five credit cards. About one-third had more than 5 cards, and 11 percent had more than 10 cards. Is this evidence of aggressive lending, lenient lending, irresponsible lending, or maybe irresponsible borrowing? You can fit whatever term you would like.

Do creditors really know their clients' financial situation? Do they really include all relevant variables as they try to determine their risk? Just like our attitudes toward borrowing and lending are relaxed, so are our attitudes toward filing bankruptcy. It is much more acceptable today. However, people are not proud of filing bankruptcy. There is a sense of failure and embarrassment, and there are many, many quotes in my study, but I will share one with you.

When I asked, how do you feel about filing bankruptcy, one quote, "humiliation of having to admit that I can't manage my money, horrible feeling of loss of self-worth." When I asked how, in your opinion, the bankruptcy process may be improved, these responses can be grouped into four areas. No. 1, "cry for more information about bankruptcy process." "Explain laws in plain English, give information about consequences of bankruptcy before we file."

The second area: concern about lawyers' practices. Another quote: "Lawyers should be made to explain details of the process and consequences instead of taking money and moving you through the system like cattle."

The fourth area, request for opportunity to learn money management before and after bankruptcy. Another quote: "During bankruptcy, provide the training on handling credit and money management to avoid future problems and count this participation toward getting credit back." Many of them said those who repay their debt by filing chapter 13 makes it easy for them to access credit in the future.

However, some of our respondents did not feel that the bankruptcy system needed any improvement. In their opinion, the problem lies with the ease of credit. "Creditors keep increasing your debt limit until you have problems. Then they forget how friendly they were when lending you money." Another quote: "I learned credit cards were the worst thing I could ever get involved in. Just when I would get caught up, it was too easy to use again and again."



If available, a large majority, almost 70 percent, would participate in credit rehabilitation programs. Sixty percent would participate in programs explaining the bankruptcy process and its consequences. Twenty-seven percent would participate in programs dealing with gambling and compulsive buying.

To address the concern of rising bankruptcy, we need a multifaceted approach. This means responsible lending practices, monitoring of card members' behavior, and intervention to help prevent problems before they occur. We need money management and credit education, starting at home, by parents, schools, and creditors. When marketing the product, creditors should also market the information on how to handle those products better. Third, realize that causes and consequences of debt problems differ by filers. It is crucial that one standard process of unconditional, full, and automatic discharge be not applied to all who enter the bankruptcy system.

I will close by just suggesting the bankruptcy issue today is bigger than an overextended debtor. We have to think differently than we ever thought before. We must focus on keeping our debtors from falling off the cliff rather than cleaning up after they have fallen off. We must increase the knowledge base and create a safe credit environment.

Thank you for giving me this opportunity.

[The prepared statement of Ms. Hira follows:]

#### PREPARED STATEMENT OF TAHIRA K. HIRA

##### SUMMARY

No single factor is sufficiently powerful enough to explain increasing number of consumer bankruptcies in a booming economy. The environment in which this is happening is created by actions of borrowers, lenders, retailers, lawyers, parents, educators, and policy makers. Some factors of this environment leading to so many financial failures include shift from debt to credit, aggressive lending, and large number of products to understand and choose from, casual attitude toward borrowing and limited knowledge to manage credit. The profile of the debtor in bankruptcy has significantly changed over the last two decades. The view of the debtors as concentrated among blue collar marginally employed or unemployed, facing a financial emergency has no foundation.

In this environment filing bankruptcy makes economic sense, it is easy, it is quick and it is simple. Researchers have established that controlling for economic variables, all families who would benefit from bankruptcy actually do not file. Bankruptcy numbers could be much higher. Dynamics of the debtors' decision to file bankruptcy are far more complex than the maximization of economic utility.

What is our philosophy about increasing incidences of financial failures? Should the bankruptcy system serve as an official debt collection agency for creditors? Or should it provide unconditional relief to debtors by wiping out all of their debts? Should our focus be on keeping financial failures from happening or should the focus be on cleaning up after the failures have occurred?

Over 70 percent of debtors identified collection actions taken by creditors as the most important factor leading to their decision to file bankruptcy. Most debtors learned about bankruptcy from friends, relatives, and through lawyer advertisements on TV, radio, and newspaper. Some respondents mentioned lawyers' hotlines and offers for free consultation. According to one respondent, "the television airwaves are saturated with lawyer ads about bankruptcy." Decision to file and under which bankruptcy chapter which chapter to file was greatly influenced by their attorney. However, many debtors indicated they chose to file chapter 13 because they wanted to pay back the debt they owed. Following quotes reflect their feelings, "we wanted to pay our debts", "too much pride", "to raise my self esteem." They also indicated that "chapter 13 provides an honorable way out of a very difficult situation.

Debtors requested that "there should be strict guidelines for lawyers as to inform clients fairly and not for their own wallets." "The lawyers should be made to explain

details instead of taking the money and moving you through the system like cattle." "Lawyers who don't give written explanation of procedures and give inadequate advice and mess things up should not be allowed to collect fees and should pay the court costs." They also had specific recommendations regarding chapter 13. "For those who file under chapter 13 and repay their debts, make it easy for them to access credit in the future."

The current bankruptcy process does not include an opportunity for debtors to participate in any educational experience. However, if available a large majority of respondents (over 70 percent) indicated they would participate in credit rehabilitation and money management programs. Over 60 percent would participate in a program explaining bankruptcy process. Some asked: "provide more training on handling money to avoid future money problems", and "have participation in such courses count towards getting credit back." A smaller proportion (27 percent) indicated they would participate in an educational program on dealing with gambling and compulsive buying behavior.

To prevent future financial failures credit education must be included in the core curriculum of educational programs at various levels. In addition adult education courses in personal finance should be available for those currently not in school. Among other topics these courses should focus on how to establish a good credit history, how to recognize indicators of financial problems, and how to handle over-indebtedness.

#### PEOPLE BEHIND BANKRUPTCY NUMBERS

This presentation is based on data collected from 200 debtors who filed chapter 13 bankruptcy. This survey is currently under way at Iowa State University. In this study among other things the objective is to establish the extent to which gambling debt is a factor in filing bankruptcy. Over the last 20 years I have conducted several bankruptcy studies. The focus of my research has been to understand underlying causes of bankruptcy and its impact on debtor's personal and financial life.

#### WHY SO MANY FINANCIAL FAILURES IN A BOOMING ECONOMY?

We live in a culture of blame, where tragedy works better if we could find bad guys (gals?). However, the reality is that no single factor is sufficiently powerful enough to explain increasing number of consumer bankruptcies in a booming economy. The environment in which this is happening is created by actions of borrowers, lenders, retailers, lawyers, parents, educators, and policy makers. Some factors of this environment leading to so many financial failures include shift from debt to credit, aggressive lending, large number of products to understand and choose from, casual attitude toward borrowing, and limited knowledge to manage credit. Many borrowers do not understand the consequences of large credit card balances and making minimum payments only. Others get into financial difficulties due to marital problems, medical bills, compulsive buying behavior, and gambling.

In this environment filing bankruptcy makes economic sense, it is easy, it is quick and it is simple. Researchers have established that controlling for economic variables, all families who would benefit from bankruptcy actually do not file. Bankruptcy numbers could be much higher. Dynamics of the debtors' decision to file bankruptcy are far more complex than the maximization of economic utility.

#### FACTORS THAT INFLUENCING DECISION TO FILE BANKRUPTCY

Over 70 percent of respondents identified collection actions taken by creditors as the most important factor leading to their decision to file bankruptcy. Most people file bankruptcy because they are not able to renegotiate affordable payments, and cannot cope with the stress of collection calls. Before filing bankruptcy some sought help from banks (46 percent) and others went to credit counseling service (35 percent). About one third filed within 1-2 years of having financial problems. Majority indicated that their financial difficulties were effecting their marriage, health and emotional stability.

Most debtors learned about bankruptcy from friends, relatives, and through lawyer advertisements on TV, radio, and newspaper. Some respondents mentioned lawyers' hotlines and offers for free consultation. According to one respondent, "the television airwaves are saturated with lawyer ads about bankruptcy." Decision to file and under which bankruptcy chapter which chapter to file was greatly influenced by their attorney. However, many debtors indicated they chose to file chapter 13 because they wanted to pay back the debt they owed. Following quotes reflect their feelings, "we wanted to pay our debts", "too much pride", "to raise my self esteem." They also indicated that "chapter 13 provides an honorable way out of a very difficult situation."



## WHO FILES BANKRUPTCY?

The profile of the debtor in bankruptcy has significantly changed over the last two decades. The view of the debtors as concentrated among blue collar marginally employed or unemployed, facing a financial emergency has no foundation. Debtors in bankruptcy now represent a group of middle class Americans. Over 70 percent were employed and married, most lived in three-person households. They were relatively young (mean age 39 years). Males and females were equally represented, and almost all were white (96 percent). They represented a wide array of occupations and their mean take home income was \$28,560. Mean debt excluding mortgage was \$35,073. A large majority (65 percent) owed most of their debt to credit cards. The average monthly debt payment was \$1,327. On an average this group had five credit cards. However, a small proportion of them had lot more cards, 21 percent had 5-10 cards, and 11 percent had 10 or more cards.

## BEST AND THE WORST ABOUT BANKRUPTCY EXPERIENCE

Responses to a question "what is most appealing aspect of the decision to file bankruptcy?" varied greatly. Some said: "there is nothing appealing about the shame and loss of pride which is part of bankruptcy, "it is a desperate measure", "it stops families from breaking apart. The most frequent responses were: "no more phone calls from creditors", "relief from debt", "it's fairly easy", "chance to start all over."

Responses to the questions "what are the worst things about bankruptcy ranged from "can't think of anything", "was not as bad as I imagined", to "feelings of failure", "horrible feelings of loss of self worth", "embarrassment and shame", "stigma attached to it", "ruined credit", "the games lawyers play with your life." However, if need be most of them would file bankruptcy again and will also recommend to others in similar circumstances.

They were asked how in their opinion the current bankruptcy process might be improved. Some of their suggestions are indicative of the issues we are struggling with today. They said: "explain laws and terms in plain English", "we need help and education before we get to this point." Some of their suggestions specifically dealt with role lawyers play in bankruptcy process. "There should be strict guidelines for lawyers as to inform clients fairly and not for their own wallets." "The lawyers should be made to explain details instead of taking the money and moving you through the system like cattle." "Lawyers who don't give written explanation of procedures and give inadequate advice and mess things up should not be allowed to collect fees and should pay the court costs." They also had specific recommendations regarding chapter 13. "For those who file under chapter 13 and repay their debts, make it easy for them to access credit in the future."

Some respondents on the other hand did not see any problem with the bankruptcy system. They said the problem lies with the ease to acquire credit, "creditors keep increasing your debt limits until you have a problem, then they forget how friendly they were when lending you money."

A small proportion of the respondents indicated that they have had the opportunity to gain financial management skills. About one fourth indicated that their parents were the source of this knowledge. An even smaller proportion (16 percent) indicated they learned money management skills from schools. Responses to the question, "what is the most important thing you learned through bankruptcy experience?" reinforce the view that many debtors lack knowledge and skills to manage their debt. Through their bankruptcy experience they learned basic principles of financial management they should have been taught at homes and schools. They learned: "stay on budget, pay bills on time," "not to spend money I don't have," "use cash only" and "handle money wisely." One respondent reported "I learned credit cards were the worst thing I could ever get involved, just when I would get caught up it was too easy to use again and again."

The current bankruptcy process does not include an opportunity for debtors to participate in any educational experience. However, if available a large majority of respondents (over 70 percent) indicated they would participate in credit rehabilitation and money management programs. Over 60 percent would participate in a program explaining bankruptcy process. Some asked: "provide more training on handling money to avoid future money problems", and "have participation in such courses count towards getting credit back." A smaller proportion (27 percent) indicated they would participate in an educational program on dealing with gambling and compulsive buying behavior.

## POLICY IMPLICATIONS

What is our philosophy about increasing incidences of financial failures? Should the bankruptcy system serve as an official debt collection agency for creditors? Or should it provide unconditional relief to debtors by wiping out all of their debts? Should our focus be on keeping financial failures from happening or should the focus be on cleaning up after the failures have occurred?

To prevent future financial failures it is important that before granting credit lenders assess consumers' ability to handle the amount granted. During the life of loan debt re-payment patterns be monitored and credit counseling be provided to those in danger of default. Majority of the respondents in this study indicated they did not get any training in financial matters from their parents. Parents must take responsibility for teaching their children necessary skills to manage money and credit.

To prevent future financial failures credit education must be included in the core curriculum of educational programs at various levels. In addition adult education courses in personal finance should be available for those currently not in school. Among other topics these courses should focus on how to establish a good credit history, how to recognize indicators of financial problems, and how to handle over-indebtedness.

Causes and consequences of debt problems differ by filers, however under the current bankruptcy system a standard discharge is granted to all without assessing the ability to repay and need for rehabilitation. Many debtors themselves do not understand causes of bankruptcy as most file bankruptcy to protect themselves from collector's calls. For the bankruptcy solution to be effective it is important that the process focuses on understanding underlying causes of financial failure and emphasis is shifted from "fresh start" to "rehabilitation."

Furthermore, the bankruptcy process must include a step where assessment is made and debtors are advised about other suitable options to their debt problems. Unconditional and full discharge should not be granted automatically to all that apply. Similarly, current and future income—an important variable when the credit is granted should be a consideration before a discharge is granted. To encourage debtors to pay part or all of their debts by selecting chapter 13, it is crucial that creditors treat these debtors favorably for consideration of future credit.

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Senator GRASSLEY. Mr. Wallace.

#### STATEMENT OF GEORGE J. WALLACE

Mr. WALLACE. Thank you very much for the opportunity to talk to you today. My name is George Wallace. I am a partner with Eckert, Seamans, Cherin and Mellott, a law firm here in Washington. I am a bankruptcy practitioner. I also have a specialty in consumer credit. I am here today representing the American Financial Services Association and I understand that my views today are consonant with theirs.

Our views on S. 1301 are essentially favorable. We believe that the philosophy and goals of the bill are extremely good, necessary; that this sort of reform is necessary this year. Others today have already talked about the spiraling rate of bankruptcy filing and about the impact that that is having both upon the bankruptcy system itself and upon bill-paying American consumers. There is definitely a need for reform. The question is not whether there should be reform, but instead what shape that reform should take.

S. 1301 takes a particular approach. The philosophy and goals of title I are to adopt a needs-based bankruptcy approach, a means-testing of the availability of chapter 7. We strongly support that approach. There is no question that it is necessary at this time. The only question, as I said before, is how it is done. We do have some concerns as to whether or not the approach taken by title I will be effective.

Our concerns begin from the question of whether or not this attempt to beef up section 707(b) will be any more effective than the present 707(b). 707(b) has been in our law since 1984 and it is generally recognized as being a dead letter, ineffective except in the most extraordinary situation. The law that has developed under 707(b) is quite clear. If the debtor has the ability to pay a significant portion of their debts, they must use chapter 13. But that is not the effect in case after case, as the statisticians who will be speaking later today will point out.

So we have a provision in our law that is not effective and the attempt is made by S. 1301 to address the need for reform by trying to make it work. Will it be effective? We are somewhat ques-