

ISSUE BRIEF

Bankruptcy Reform

National unemployment figures are higher than at any time since 1992, and according to the Mortgage Bankers Association of America, mortgage foreclosures are at their highest level in 30 years. In addition, more workers and their families are facing medical bills without adequate insurance, according to the U.S. Census Bureau. Congress should recognize the state of the economy and reject any legislation that will exacerbate the pressures facing working families and limit the possibility of recovery from financial catastrophe. Instead, Congress should expand the rights of employees working for companies under bankruptcy protection, shield consumers from unscrupulous creditors and close existing loopholes that allow wealthy debtors to shield assets from creditors.

More than four years ago, the nonpartisan National Bankruptcy Review Commission proposed revisions to the bankruptcy code. Their recommendations aimed to balance the needs of debtors with the concerns of creditors and reflect the changing realities of today's global economy. However, the bills that emerged from Congress distorted those recommendations and were deeply flawed. If enacted into law, millions of working families who desperately need relief from debts resulting from medical problems, unemployment and other causes beyond their control would have been unable to gain a fresh start through the bankruptcy process.

Bankruptcy reform should not add to the financial pressures on working families. Long-term unemployment is higher than it has been in years. According to the Bureau of Labor Statistics, the number of Americans without health insurance has increased by two million over last year. Millions of workers have lost retirement savings due to corporate fraud and malfeasance. Not surprisingly, bankruptcy filings generally increase about one year after a downturn in the economy and, according to the Administrative Office of the U.S. Courts, have reached unprecedented numbers in recent years. The fastest growing groups of bankruptcy filers are the elderly and women in single-parent households. Experts, such as Professor Elizabeth Warren of the Harvard Law School, believe the problem will worsen given the declining value of retirement savings accounts, the increased cost of prescription drugs and the aging of baby boomers saddled with debt. Legislation passed before the economy was shaken by a wave of corporate scandals and massive layoffs should not serve as the basis for reform.

Reform should balance the interests of creditors and debtors. The Federal Reserve reports that the total amount of personal debt has more than doubled over the last decade, reaching a record \$1.7 trillion through October 2002. The credit card industry mailed 5 billion solicitations for credit cards last year, according to BAI Global Inc., and the Federal Deposit Insurance Corporation reported bank profits were up 34.8 percent in the third quarter of last year, despite having to write off \$3.9 billion in credit card debt. This profit margin reflects the difference between the 1.25 percent rate banks pay to borrow from the Federal Reserve and the 17 to 22 percent rate charged to many consumers for credit. The credit industry knows these profits will continue as long as consumers make the minimum payments, which are encouraged by the industry without receiving adequate disclosure of the consequences of making such low payments. As has been well reported, credit cards are aggressively marketed even to the poorest risks—people who can be expected to make only minimum payments.

According to the nonpartisan American Bankruptcy Institute, approximately 90 percent of individuals file for bankruptcy only as a last resort—when they face financial catastrophe after the loss of a job, divorce or medical crisis. Given the state of the economy, it is unsurprising that reported consumer bankruptcy filings in fiscal year 2002 were up 7.7 percent from fiscal year 2001.

Congress should improve the standing of workers whose employers file for bankruptcy.

Approximately 40,000 businesses file for bankruptcy every year, according to the Administrative Office of the U.S. Courts, but last year bankrupt companies left more workers on the streets than any year in recent history. These workers generally received only the statutory cap of \$4,650, no matter how much they were owed in wages, severance, vacation and employer contributions to retirement savings and health plans. New bankruptcy legislation should increase the statutory cap for compensation owed to employees of bankrupt companies and raise the priority in bankruptcy of 401(k) plan beneficiaries who are victims of employer stock or pension fraud. New legislation should also allow for recovery of excessive executive compensation paid just before a company files for bankruptcy. Individuals whose lives are ruined by their employer's behavior should not be forced to scramble for the little that remains after banks and other preferred creditors get their share.