SECTION IV

Stronger Family Balance Sheets: Debts

Continuing our focus on improving family balance sheets, we now turn to the liability side: household debts—whether from credit cards, mortgages, student loans, health expenses, municipal fines and fees, automobiles or informal debts owed to family and friends. Debts, of course, like compound interest, can be both wealth depleting and wealth building—depending especially on the terms and whether and how they secure associated assets. Debts have also become a symptom of broader financial insecurity—the method families use to stay afloat amidst uneven or diminishing wages and rising and unpredictable expenses.

The five essays featured in this section begin with a vision for bringing a certain level of respect or dignity to those who hold the debts—a relatively novel idea that has encouraging parallels in the health care sector. One essay highlights an innovative employer program to help younger employees pay down their student loans while also saving for retirement. Another contributor offers a plan for a fresh start from overwhelming levels of debt and poor credit. And two essays look refreshingly at court systems and municipalities that heavily penalize poorer and lower-wealth households and offer novel ways forward that can serve as national models.

Bringing Dignity to Debts

BY FREDERICK F. WHERRY

The views expressed in this article are those of the individual author/authors and do not represent the views of or an endorsement by the Federal Reserve Bank of St. Louis, the Federal Reserve Board of Governors, the Federal Reserve System or the U.S. Department of Agriculture.

Former Georgia gubernatorial candidate Stacey Abrams admits to having made a few mistakes, but her money problems shouldn't count among them. At least not as a mistake so grave as to disqualify her for office. She had defended her family's dignity, and she did it through debt.

Two decades after finishing law school, Abrams still owed money, too much money. As her supporters tried to make sense of her circumstances, they turned first to her family situation that seemed to leave her with no choice. She had helped her parents, who were ministers responsible for their flock, and other family members recover after the devastations of Hurricane Katrina. This recovery required not only that they survive the catastrophe but also that they do so with a sense of dignity. Apparently, dignity comes at a high price, and perhaps its price, in her case, was too high. Her enemies immediately saw an opening. How could Abrams be trusted to handle the finances of Georgia when she couldn't handle her own? There is dignity, too, in self-control and sacrifice, in suffering and allowing others to suffer, if those hardships are borne with a sense of grace.

The kind of dignity that drove Abrams into debt, however, required a deep sense of responsibility for her loved ones and a great deal of fortitude to honor one's commitments. She became the family's social safety net. Presumably, she knew what the outside world would say about learning the difference between absolute needs versus wants, about what is enough, about the need to put on your own oxygen mask before trying to help your neighbor. And public knowledge of her debts would be a weapon used against her. The content of her character could not smooth the crinkles in her credit. No doubt, she had seen this treatment before as she witnessed banks, credit card companies and debt collectors trample the privacy rights of debtors in her community, letting everyone know that the debtor who needs to call them back, needs to make a payment, is about to be in terrifying trouble. The right to respect ended where nonpayments began. She was making payments; they were just too small for a debt that big.

The right to respect ended where nonpayments began.

If debt were a biological disease, we would know how to treat it with respect. We would not begin by asking how the person brought the disease on themselves. Instead, we would start with how the person is feeling, exploring options to bring about comfort in their suffering. The health care staff would also avoid using the fastest routes to clean and to otherwise handle the person's body to allow that person to feel as if they still have a right to privacy. The genitalia would be draped, the bowels treated with care. After all, the sick still have a right to be treated as if their lives are as worthy of attention and reverence. The nurses and doctors would enlist the family members to encourage the patient, recognizing their importance for any plan of recovery. In short, the cure would come with compassion, privacy would be protected and the patient would continue to perform their social roles as adults, parents, as people with relationships, social obligations and decision-making authority.

Rather than a therapeutic medical model, the financial sector has relied on a dismal view of human behavior to determine how to treat debtors. Economists will tell you that if people can get away with not paying what they owe, they will. Inflicting pain through indignities keeps creditors from ruin. The supply of borrowing would presumably fall short without these forms of suffering.

The dismal science, however, would do well to test their assumptions on actual people using debt. Is it possible to treat people with dignity without disincentivizing repayment? What would need to change? Researchers have found that an individual's self-esteem and sense of mastery vary by the type of debt they carry and its amount, along with the socioeconomic status of the debtor. While student loans start out feeling like the route to opportunity and respect, for example, it transforms into an overwhelming burden, particularly for Black borrowers. Imagine being the median Black borrower who went to college to invest in themselves, only to find that after paying on the debt for 20 years, they still owe 95% of the principal. The horror comes with humiliation as these borrowers are hounded to do what their incomes will not allow. Studies also show that debtors are responsive to appeals that treat them with respect. Those who owe municipal taxes reacted well to letters highlighting their normality and social norms.

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And debtors summoned to court performed better when they could overcome feelings of shame, embarrassment and hopelessness.

The way that people experience painful indignities varies. In some communities, financial distress occurs widely across the census tract. Even when controlling for income and education, census tracts with a higher percentage of Black residents will have more predatory financial services located in their neighborhoods. This means that as parents try to respond to the needs of their children and as children try to assist aging parents with inadequate retirement savings, they are more likely to come into contact with toxic resources. Their aversion to risk goes down as their sense of obligation to family goes up. And they meet these obligations by taking great care to avoid embarrassment for themselves and for those they assist. Some debtors will be new to debt collection efforts, so a prick of pain might pluck a favorable response (repayment). For those in chronic debt, these pricks will elicit less efficacious responses. As painful debt collection efforts degrade their sense of worth, their feeling of control, they leave nothing to look forward to except more indignities, more embarrassments and more opportunities to avoid these indignities at a high cost to the debtor and a low payout to the creditor.

It doesn't have to be this way. Just as health care providers use a dignity inventory in assessing the care they deliver to patients at the end of life, financial service providers can conduct dignity assessments of how their products and services are delivered to consumers, paying particular attention to those consumers who are the most financially frail. And just as some medicines are over the counter while others are more tightly controlled, so too should be the financial products and services that predictably lead to over-indebtedness. If affordable loans were the norm, people would not be paying three to five times the principal and still be on the hook. If debtors had a right to respect, they could carry debt obligations based on their capacities to repay and with their heads held high. This would be a move toward decency in economic affairs, a move long overdue.

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Respond, Restructure, Rebound: A Path to Prosperity Following a Financial Shock

BY R. JERRY NEMORIN

The views expressed in this article are those of the individual author/authors and do not represent the views of or an endorsement by the Federal Reserve Bank of St. Louis, the Federal Reserve Board of Governors, the Federal Reserve System or the U.S. Department of Agriculture.

Paul and his wife Nancy were a fairly comfortable middle-class couple. They owned their home, with significant equity. They had good credit scores.

When Nancy was diagnosed with cancer, it set in motion a series of financially draining events that put them on a path toward bankruptcy.

Alongside the stress and emotion of taking care of a sick loved one, Paul had to bear the cost of maintaining the household as well as the additional expenses tied to Nancy's cancer treatments with only one income. To cover the additional expenses, Paul used their credit cards. When keeping up with the monthly payments became difficult, he attempted to tap into the equity in their home. Unfortunately, he discovered that this route was unavailable because both of their credit profiles had suffered as a result of the loss of income and the additional new debt.

Inaccessible Wealth

Most households in the U.S. don't have the buffer to cope with a financial shock. According to the Federal Reserve, 66% of all households in the U.S are homeowning households. Like Paul, their wealth is predominantly tied to the equity in their home. However, this wealth is generally not only inaccessible in a time of distress but is also at risk of loss in a foreclosure or bankruptcy.

This risk is even more acute depending on one's income bracket. For homeowning low-income households, housing wealth accounts for nearly 75% of total assets, compared to 34% for high-income households. For middle- and low-income households, these shocks can result in insurmountable debt, which can lead to legal collections or bankruptcy.

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A Tarnished Future

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Over the last 20 years, debt collection lawsuits have doubled. More than 90% of people who are sued by their creditors don't have legal representation and are often absent from the collection proceedings. In the states where data are available, 70% of debt collection lawsuits are resolved by a default judgement for the creditors.

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Debt collection judgment and bankruptcy can lead to wage garnishment, jeopardize future employability and impair access to housing.

Path to Prosperity: Respond, Restructure, Rebound

Our systems should help propel people forward during times of distress. The existing products and policies available to support the average American navigating these types of shocks are not designed to set them up for success. We need public and private innovation in this space to create the appropriate systems and tools that will allow for a more holistic path to recovery and prosperity.

The path to recovery begins with *responding* to the individual's most pressing need in times of distress. Prior to the pandemic, the government's unemployment benefits program aimed to solve this by paying roughly half of someone's income for up to 26 weeks. A more robust program would include a government-mandated, employer-subsidized supplemental insurance to cover the remaining amount. The government could further enhance the impact of these programs by providing incentives to private entities to create lending solutions designed to help the individuals get back on their feet. These incentives could include debt guarantees or access to low interest rates. For homeowners, these solutions could be a sale-leaseback transaction, fractional equity sale or a partial cash refinancing that unlocks access to the equity in their home and empowers them to take control of the moment.

Once the individual is supported to take control of the moment, it opens up the path to a more holistic *restructuring* of their financial lives. This restructuring approach should take into account the person's new realities: their income, debt, expenses and long-term opportunities for financial security. Today, restructuring primarily consists of bankruptcy. Over the past five years, more than 750,000 consumers each year have used bankruptcy to restructure their financial lives. Bankruptcy lasts up to 10 years on credit reports and has a lasting detrimental impact on employment, housing and access to credit. A more sustainable approach would involve a third-party refinancing of the consumer's debt supplemented by concessions from their existing creditors to allow for payments based on their current financial conditions. This solution would provide higher recovery for the creditors while taking a collaborative and rehabilitative approach to collections—rather than the adversarial and punitive legal process.

For those who absolutely have to go the bankruptcy route, their future should be protected as well. Their home should be protected with a homestead exemption, portion of student loan debt should be dischargeable, and they should be allowed a one-time "expungement" of the bankruptcy filing and should never have to face the question "have you ever filed for bankruptcy?" on housing and employment applications.

Finally, the path to prosperity requires systems and tools to enable the individual to rebound from their distress and also to invest in longer term value creating assets. Historically, the stock market was inaccessible as it required a significant amount of capital for investment. Today, what are called "fractional shares" allow retail investors to participate in the wealth creation process with as little as a $1 investment. This innovative investment approach should not be limited to just publicly traded stocks. It should be expanded to include privately held assets such as startup investments, real estate, debt portfolios and bonds. The government should incentivize structures that responsibly give retail investors access to high growth opportunities that today are limited to accredited investors. The accredited investor rules primarily exclude retail investors from the massive wealth being created by emerging innovative companies.

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Being able to rebound from a financial shock should not be as difficult as what Paul and Nancy experienced. Our slightly evolved debtor prisons system is designed to punish rather than rehabilitate. We have the knowledge, data and technology today to build a better system. Imagine a society with the tools that empower households to successfully respond to shocks, restructure their financial lives to fit their current situation and rebound stronger by building a portfolio of assets that enable long-term financial security. It is not far-fetched, but it requires public-private partnerships to make it happen. A more financially resilient society would be a win for our local and federal government, our financial system and our economy.

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R. Jerry Nemorin is the founder and CEO of LendStreet, an online lending platform that enables individuals who have weathered a financial shock to settle prior debts and rebuild their financial lives. He is also a board member of three nonprofit organizations (Moneythink, Fonkoze and Money Management International) that are solving for financial inclusion and financial security.

Fair Fines and Fees: How San Francisco is Leading the National Movement for Financial Justice

BY JOSÉ CISNEROS AND ANNE STUHLDREHER

Just after Gavin Newsom was elected governor of California, the organization SaverLife surveyed its members—typically Black and Latino mothers earning under $22,000 a year—about what the new governor could do to help them. "Lower the cost of local and state fines and fees" was the second most common response.

In San Francisco, we were not surprised.

A few years earlier, the Debt Free SF community coalition started up to protest what they called government-sanctioned gouging through tickets, fines and fees. They were outraged by a whole array of fiscal punishments that they perceived were disproportionately doled out to people without the resources to pay.

Don't have money to pay a traffic ticket that costs a few hundred dollars? Here's a $300 late fee and a suspended driver's license. Struggling to pay a $75 parking ticket? The city can double it through late fees. Towed? That's $500. No wonder many people just gave up their car to the impound.

People experiencing homelessness or who'd been incarcerated—the least able to pay fines—also racked up big bills. They could be fined $200 for sleeping on a park bench, up to $35 a day to "rent" an electronic ankle monitor while on home supervision or $1,800 up front to pay for monthly fees for the typical three-year probation term. Money bail averaged $50,000 in California. If you were rich, you could get out of jail to await your trial. But if you were poor, forget it. There was a two-tier system of justice.

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A pattern started to emerge. If you could pay, you barely felt the brunt of these penalties. But if you couldn't, a cascade of consequences could set in. What started as a small problem would grow into a big one and derail people's lives.

It looked like we were doling out two sets of punishments—one for the rich and a more punitive one for the poor.

As the entity in charge of revenue collection for our $13 billion city and county, we knew there had to be a better way. Excessive fines and fees that exceed people's ability to pay create a lose-lose arrangement, for government and for people. Surely we could adjust our fines to hold people accountable without putting them in financial distress. And we should be able to balance our books without slapping fees on people at the margins.

In 2016 we launched the Financial Justice Project to assess and reform fines and fees that have adverse disproportionate impacts on people with low incomes and communities of color. We have worked with other departments, the courts and community groups to make dozens of fines more fair and eliminated fees that don't make sense.

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The sky has not fallen. Sometimes, the revenue losses are minimal or nonexistent. Many of the results are surprising, and the reforms are starting to spread to other places.

For common fines like traffic and parking tickets or towing fines, we've created sliding scale discounts for people with low incomes. Someone who is poor shouldn't have to pay a bigger penalty for a ticket—like forgoing groceries—just because their wallet is thinner.

We've also eliminated penalties that punish people for their poverty. San Francisco Traffic Court was the first in California to stop suspending people's driver's licenses when they could not afford to pay their traffic tickets or missed a court date.

The penalty was too extreme. Studies have shown about 40% of people lose their jobs within six months of having their license suspended. Plus, there were less onerous ways to encourage people to pay. The court started sending reminders, like monthly billing statements, and offering payment plans and discounts based on people's ability to pay.

Critics thought we were being softies and risked revenue losses, but this never happened. The revenue the court collected per citation remained stable and even slightly increased. Research shows that court programs that base fines and fees on people's incomes can bring in more revenue than flat-rate fines. The reform became statewide law in California, and eight other states have since eliminated this onerous penalty.

We also eliminated local fees charged to people in the criminal justice system, like the $1,800 in monthly probation fees and the up to $35 a day fee for an electronic ankle monitor. People exiting jail rarely have jobs, and these fees set them up to fail. The purpose of fees is to cover costs, but the collection rate was just 9% on the largest fee. A few years later, the Debt Free Justice Coalition propelled the passage of the Families Over Fees Act to eliminate the same fees statewide in California.

A national movement for reform is growing to ensure fines and fees are more fair and that people at the margins don't face steeper penalties because of their poverty. Along with PolicyLink and the Fines and Fees Justice Center, we've launched Cities and Counties for Fine and Fee Justice. The Biden administration included fine and fee reform in its policy platform, calling for an end to money bail and debt-based driver's license suspensions, and aims to stop debtor's prisons, stating that people should not be jailed when they cannot pay fines and fees. The recently passed American Rescue Plan Act also presents an opportunity for states and localities to use federal funding to eliminate criminal legal fees and base fines on ability to pay, based on recommendations from the Center on Budget and Policy Priorities and the Fines and Fees Justice Center.

The public is demanding change too. A recent poll from the Fines and Fees Justice Center found that 80% of voters support reducing or replacing fines for minor violations of the law, and 79% believe government revenue should not depend on more fines, fees and tickets.

During the last recession, to fill budget gaps, some state and local governments dramatically increased the number of fines and fees for minor traffic and municipal code violations as well as for misdemeanors and felonies. Low-income people and communities of color felt the biggest brunt of this regressive form of taxation.

Let's not repeat the mistakes of the past. Policymakers at the local, state and national level can advance reforms that make a real difference in people's lives. Local officials can start by reaching out to legal services and social services organizations that see up close how people struggle to pay fines and fees. They can make fines more fair by creating sliding scale discounts and eliminate fees if they're charged exclusively to people with low incomes. Here is a list of fine and fee reforms[1] we've enacted in San Francisco that can give local leaders a sense of what is possible.

At the state level, dozens of states still suspend people's driver's licenses when they cannot pay traffic tickets. Not being able to pay your traffic tickets often has everything to do with poverty and nothing to do with dangerous driving, and states should end this unproductive penalty now. The Free to Drive campaign has resources for policymakers who want to explore this reform. Furthermore, about 30 states restrict the voting rights of people who owe fines and fees. These restrictions disenfranchise the poor and people of color, and policymakers should eliminate them. State policymakers can eliminate modern-day debtor's prisons in their state and ensure people are not incarcerated when they cannot pay fines and fees.

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At the national level, there is bipartisan support for the fine and fee reforms put forward by the Biden administration that policymakers can advance now.

The economic fallout of the COVID-19 pandemic has caused record numbers of Americans to file for unemployment and fall deeper into poverty. Policymakers are rightly focused on doing everything they can to build up people's economic reserves—through expanding the Earned Income Tax Credit and Child Tax Credit, for example. But let's remember to not deplete the reserves of people at the margins through sky-high fines and fees.

For the millions struggling right now, the last thing we need is for one hand of the government to take out what the other hand puts in.

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[1] Also available at sfgov.org/financialjustice

Generational Double Threat—and Opportunity: Student Loans and Retirement Security

Innovative programs can help employees simultaneously eliminate educational debt and save for retirement

BY DIEGO MARTINEZ AND ROMY F. PARZICK

Leahannah Taylor's professional future was bright when she graduated from Rutgers University with a master's degree in biomedical sciences in 2019. Her resume was strong, filled with impressive job and volunteer experience, and she exuded excitement about helping to shape the future of health.

But Taylor didn't have the same positive outlook about her student loans. By the time she started looking for a job, she had accumulated nearly $60,000 in educational debt from earning her undergraduate and graduate degrees.

"I just wanted the debt done," Taylor says. "I wanted it gone. You've just made this great accomplishment, earning your degrees, and then you're left starting life in the red. I wanted to be in the green sooner rather than later."

She had other job offers, but it was the hands-on patient work as a clinical specialist at Abbott that tipped the scales for her, along with the health care technology company's Freedom 2 Save program. The program allows the company to contribute 5% of employees' eligible pay to their 401(k) if they pay at least 2% of their salary toward student loans each year.

Two years later, after aggressively paying down her college loans, the 26-year-old is debt-free and working to purchase her first property. Meanwhile, Taylor started her retirement savings early and, by taking advantage of compound interest, has a 401(k) account that could be worth hundreds of thousands more by the time she retires. Taylor credits the Freedom 2 Save program for contributing to her success.

Acknowledging the Dilemma

The amount of student debt amassed in the U.S. is staggering: $1.7 trillion in loans owed by 45 million Americans. By 2027, the debt load is expected to double to a whopping $3 trillion. This is happening while (and partly because), for decades, wages have stagnated and the cost of education has skyrocketed. Since the 1980s, the cost to attend a university has increased nearly eight times faster than wages. Today, about 70% of four-year graduates are carrying student loan debt, and the average balance is about $37,000.

This indebtedness has long-term effects for borrowers well beyond their college or graduate school years and extends into significant, larger impacts on our economy and society. It's no surprise that when compared to the average starting salary for college graduates of about $50,000, those carrying student loan debt are more likely to delay starting a family, buying a home or saving for retirement—all of those, in turn, reducing their ability to accumulate wealth.

For younger workers, the constraints that student loan debt impose means they need to cut back—either on consumption, savings or both. And while retirement seems far off, the persistent, monthly drumbeat of student loan bills often drowns out the need to save for the long term. Among 25- to 35-year-olds who are not saving for retirement, 39% say they are prioritizing student loan payments.

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Workers in their 20s and 30s aren't alone in the challenge to balance the financial constraints imposed by their student loan burdens. Roughly 3.6 million parents have taken out $96 billion in outstanding loans under the federal Parent PLUS program as of late 2019, accounting for about a quarter of total federal lending for undergraduates.

This means a segment of our population that, ideally, would be heading into retirement with a healthy nest egg instead finds itself saddled with student loan debt. Of the parents and grandparents taking out loans for children and grandchildren, 43% say they will increase their own retirement savings once the student loans are paid off. Unfortunately, for their financial futures, if they default on these loans, the government can garnish wages and withhold tax refunds and social security checks, making retirement security much less attainable.

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Finding Solutions

Employers working to attract and retain top talent, as well as boost productivity and curb employees' financial stress, understand that helping their workers manage and pay student loan debt is a win-win proposition. Forward-thinking companies have identified this as a key workforce need and attractive addition to their benefits offerings.

In response, human resources leaders have started innovating solutions that deliver high-impact results for employers and employees. These include programs like Abbott's Freedom 2 Save, which pairs reducing workers' student loan debt with growing their retirement savings. It's an important combined effort because for every decade an employee waits to start saving for retirement, the amount of savings needed roughly doubles.

As previously mentioned, under the program, employees earn a 5% 401(k) company contribution when they show they're putting 2% of their eligible pay toward their student loans. For example, someone who joins Abbott with a starting annual pay of $70,000 and enrolls in Freedom 2 Save could see $54,000 accumulate in their 401(k) accounts over a decade, assuming a 6% average annual return and yearly merit increases of 3%, without making any 401(k) contributions of their own.

At the same time, employees participating in the program have the opportunity to potentially pay their student loans off, on average, three years faster and save thousands of dollars in interest. They would do this by taking the 2% of their pay that would have gone into their 401(k)s to qualify for their 5% company match and instead put it toward their college debt.

Companies don't have to manage these programs alone, but rather they can partner with technology platforms like Vault.co, a leading provider of student loan benefits. Vault's platform allows employers to make one-time or ongoing, tax-advantaged contributions directly to employees' student loan balances and provide retirement plan matching services like Abbott's program. And through 2025, employers have an added incentive to help with employee student loans: The Consolidated Appropriations Act of 2021 extended the CARES Act provision that allows employers to contribute up to $5,250 toward employee student loans as a tax-deductible business expense, and these contributions are excluded from employees' personal income tax responsibility.

It's obvious how offerings like these can positively impact employees' financial lives—they shouldn't have to choose between paying off student loans or saving for retirement—but there are benefits for employers as well. Companies directly benefit from the educational attainments of their workforce, so it makes business sense to help their employees manage and pay down student loan debt. Programs like these can also boost employee retention and, like in Taylor's case, be the deciding factor when a sought-after candidate is choosing between job opportunities.

Taking Action

Collaboration between the private and public sectors is crucial in developing multifaceted solutions to effectively address a mass crisis like student debt. The private sector can play a vital role by creating innovative benefits programs that help Americans with educational debt live more financially stable lives. The public sector can enact legislation that eases regulatory paths for U.S. employers to provide employees with the ability to pay down student debt while also saving for retirement. Legislative proposals similar to the Retirement Parity for Student Loans Act contain the necessary framework and provide a way for programs like Freedom 2 Save to proliferate.

Given the unique economic recovery challenges Americans will face coming out of the coronavirus pandemic, innovative solutions that align employee and employer success are paramount.

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Or, more simply put, Taylor's financial achievements don't have to be hers alone. If the business community and policymakers respond to the American student crisis with action, then thousands of others can join her in living financially healthy lives.

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Romy F. Parzick is CEO of Vault.co, the leading student loan benefits provider, based in Austin, Texas. Romy's career has been dedicated to socially responsible financial services and fintech innovation. She has been an Aspen Institute First Movers fellow since 2015 and holds a B.S. from Carnegie Mellon University and an M.B.A from Duke University's Fuqua School of Business.

Debt Collectors Are Coming to Court—But We Can Protect Families from Losing Wealth They Shouldn't Have to Lose

Court-enforced debt collection is an underrecognized factor in family balance sheets, but policy changes can protect vulnerable consumers.

BY ERIKA RICKARD

The views expressed in this article are those of the individual author/authors and do not represent the views of or an endorsement by the Federal Reserve Bank of St. Louis, the Federal Reserve Board of Governors, the Federal Reserve System or the U.S. Department of Agriculture.

As Americans confront the economic consequences of the COVID-19 pandemic, there's one place you might not expect to see family financial issues play out on a grand scale: your local courthouse. Flying largely under the radar, court dockets have increasingly become dominated by debt collection lawsuits in recent years. Now, with household finances continuing to face the fallout from the global public health emergency, a surge in medical debt, past due rent and consumer debt is expected to soon accelerate the flood of court dockets across the country.

That gives state courts a critical opportunity, before a rush of new filings hits their dockets, to address many of the challenges of debt claims—including power imbalances in courtrooms and the prevalence of automatic judgments in favor of creditors.

Even before the pandemic, creditors and third-party firms had adopted an increasingly aggressive approach to pursuing consumers for unpaid debts, using state civil courts to pursue collections via lawsuits known as debt claims. In the typical debt claim, a business—often a company that purchases delinquent debt from original creditors—sues an individual to collect on a debt, frequently for amounts under $5,000. These debt claims typically involve unpaid medical bills, credit card balances, auto loans, student debt and other types of consumer credit (excluding housing, such as mortgage or rent).

The Pew Charitable Trusts documents this growth in a recent report, which notes that from 1993 to 2013, the number of debt collection suits more than doubled nationwide, from less than 1.7 million to over 4 million and consumed a growing share of civil dockets, rising from an estimated one in nine civil cases to one in four (see figure below).

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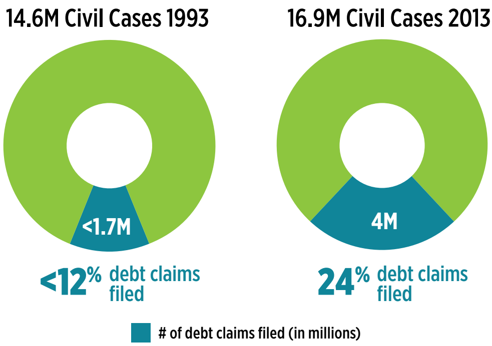
While 2013 is the last year for which national data are available, Pew followed up by examining recent annual reports from all courts that share data on debt claims—and found that debt collection lawsuits represent the single

Debt Claims More Than Doubled Over 20 Years

Consumer debt lawsuits in real terms and as a share of civil caseloads, 1993 and 2013



SOURCES: P. Hannaford-Agor, S.E. Graves, and S.S. Miller, "The Landscape fo Civil Litigation in State Courts" (2015), https://www.ncsc.org/-/media/Files/PDF/Research/CivilJusticeReport-2015.ashx; B.J. Ostrom and N.N. Kauder, "Examining the Work of State Courts, 1993: A National Perspective From the Court Statistics Project" (1995), https://www.bjs.gov/content/pub/pdf/ewsc93-npscp.pdf

most common type of civil court case today.

That shift has largely gone unnoticed by state leaders over the past 30 years, but it has profound implications for states, taxpayers and consumers.

And the problem is not just how many debt collection lawsuits are filed but what actually happens in these cases. Conventional wisdom would lead us to believe that if we walked into the courtroom for a typical court case, we would find a judge, perhaps a jury, and two parties, each represented by a lawyer.

But in the majority of debt collection cases, we would see a different scene: a judge or a magistrate, a lawyer representing lots of plaintiffs (creditors and collectors) at once, and on the other side either a consumer representing themselves or—more likely—an empty chair.

Why the empty chair? Two reasons. First, consumers in debt lawsuits rarely have attorneys: According to a survey of research on debt collection lawsuits from 2010 to 2019, fewer than 1 in 10 debt claim defendants has a lawyer, compared with nearly all plaintiffs. And having representation makes a difference: Consumers who had attorneys in a debt claim were more likely than those without attorneys to either win their cases or reach a settlement with the plaintiff.

The second reason is even more troubling. Over the past decade, multiple studies (in jurisdictions where data are available) have shown that courts have resolved more than 70% of debt collection lawsuits with default judgments for the plaintiff—meaning that the plaintiff won without even having to prove that the correct person was sued for the right amount within the legal time frame.

Multiple studies show that courts have resolved more than 70% of debt collection lawsuits in favor plaintiffs, who won without having to prove the correct person was sued for the right amount within the legal time frame.

Many consumers don't participate in their lawsuits at all—some by choice, others because they didn't receive adequate notice that they were being sued. The reality of debt collection lawsuits is that plaintiffs and their lawyers typically operate unopposed. And when only one side is in the courtroom, only one side is heard. When a defendant doesn't respond to a suit, the debt collector wins the case by default.

A default judgment carries the same weight as a judgment after trial, with consequences that can be both severe and long-lasting—with the victorious plaintiff wielding the judgment's authority to access government enforcement powers to collect on private debts. The existence of a court judgment can double the costs of the underlying debt: Courts routinely order consumers to pay accrued interest as well as court fees, which together can exceed the original amount owed.

Court judgments also open additional channels of collection, which include garnishment of wages or bank accounts, seizure of personal property and even incarceration. In 16 states, garnishing assets is unrestricted, so people can have their entire bank accounts drained.

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And although incarceration is not a common occurrence, it does happen—and 44 states permit civil arrest for contempt of a court order for payment.

While these challenges long predate the pandemic, all indicators suggest that a new wave of debt collection lawsuits will hit as states—and courts—reopen in the coming months. So leaders in all branches of government have an opportunity to ensure that courts are operating impartially in debt cases and across the civil system.

First, we have to pull back the curtain on state and local courts. The full picture of debt claim challenges and consequences remains incomplete, because most state courts don't report on their cases with sufficient detail to identify how many of their cases are debt claims and what proportion of those cases result in default judgment. But they can. Texas is a prime example: Despite decentralized decision-making and data collection across 254 counties, the Lone Star State is the only one that tracks and reports on all outcomes (including default judgments) for all cases (including debt claims) across its entire civil caseload.

If we had better state court data, we could improve state policies, court rules and common practices to ensure that both sides in debt collection lawsuits have a full opportunity to make their case.

The bottom line: State leaders can take action now to reduce government-enforced collection of invalid debt.

And even without the data to help us understand what policies are most effective, some fundamental state policy changes can begin to move the needle. Steps in the right direction include making courts responsible for letting people know they're being sued before issuing a default judgment, requiring creditors and collectors to demonstrate that the right person is being sued for the right amount, and modernizing the relationship between courts and their users by providing procedural information to all parties.

The bottom line: State leaders can take action now to reduce government-enforced collection of invalid debt, which would improve family balance sheets and ensure that the role of courts in family financial issues is a fair and impartial one.

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