BANKRUPTCY REFORM AND THE "SWEAT BOX" OF CREDIT CARD DEBT

Ronald Mann

Abstract

Those that backed the 2005 bankruptcy reform law argued that it would protect creditors from consumer abuse and lack of financial responsibility. The substantial increase in the number of bankruptcies over the last decade combined with the perception of system-wide abuse apparently convinced legislators from both political parties that the backers had a point. Thus, Congress enacted amendments to the Bankruptcy Code that – if effective – would fundamentally change the core policies underlying the consumer bankruptcy system in this country. At least part of the rhetoric surrounding the reform debates was the idea was that if borrowers had to repay more of their debts, the creditors would achieve savings that – through pressures of competition – would be passed on to consumers in the form of lower interest rates and improved access to credit. This essay addresses some of the problems with the facial justification and considers what else creditors (and particularly credit card issuers) could have expected to achieve with the new law.

My thesis is that the new law will benefit issuers substantially, though not for reasons commonly discussed in the negotiation and drafting of the statute. Means testing alone will not return enough in increased bankruptcy payouts to justify the lobbying expenditures and campaign contributions that led to the statute's enactment. Rather, I suggest, the most important effect will be to facilitate the card lending business model, by slowing the time of inevitable filings by the deeply distressed and allowing issuers to earn greater revenues from those individuals. In a nutshell, the new law does little for creditors once they reach the courthouse. Its most important effects instead will be on the ability of lenders to profit from debt servicing revenues generated by borrowers that are already in distress, but not yet in bankruptcy.