

Rehabilitating Individuals in Financial Distress: What Works?

Nearly half of Americans lack a financial cushion sufficient to survive for three months without income.¹ More than 77 million have at least one account reported as “in collection” on their credit report, owing an average of \$5,178.² Research suggests that financial distress causes lower mental function, leading to bad decisions that in turn lead to other legal problems, including eviction, divorce, and a need for government benefits. In other words:



Financial distress is a cancer affecting United States society. The failure of certain groups to emerge from the Great Recession has put a premium on answering the following question: What works to improve the financial health of those whose struggle to meet their obligations has reached the point of debt collection litigation and a ruined credit report? Social welfare and insurance programs may be of limited value unless distressed individuals become better able to extricate themselves from legal trouble, to manage their financial affairs, and to plan for the unexpected.

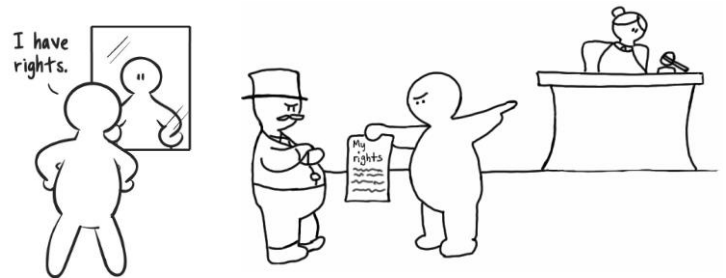
Some have suggested **legal representation**. Lawyers unquestionably have a role to play, but there will never sufficient legal aid resources to provide representation to all in need through the multiple stages of debt collection litigation, negotiation with alleged creditors, repair of credit reports, and (if needed) bankruptcy. The key, then, is to produce rigorous evidence regarding when and where to deploy scarce lawyer time and energy most effectively.

Others have suggested **financial counseling**. In 2005, Congress mandated that individuals seeking bankruptcy protection undergo a financial counseling course before receiving a discharge of

their debts, with the obvious hope that counseling would prevent future financial distress. Yet, we have no rigorous evidence to assess whether counseling improves financial health.

Given the shortage of resources, self-help materials covering legal and financial issues are essential. But the best such “self-help” materials that currently exist are, ironically, not designed to be usable by persons with limited mental bandwidth and education.³

Moreover, existing self-help materials fail to cover essential aspects of the problems do-it-yourselfers face in this arena, such as how to overcome feelings of shame and guilt, how to conduct a negotiation, and how to argue to a judge. The state of the art in this area must change. Self-help materials should communicate feelings of self-agency and optimism that individuals in financial distress can internalize:



And we need rigorous evidence of whether these materials produce results.

Finally, there are mounting allegations of mistakes and/or abuses within the debt collection industry, particularly the activities of debt buyers.⁴ Some contracts selling the rights to allegedly delinquent debt from original issuers (e.g., credit card companies) to debt buyers show

¹ Change in Liquid Asset Poverty 2006-10, Assets & Opportunity Scorecard, <http://tinyurl.com/mm6q6k4>.

² Median debt is \$1,349. DELINQUENT DEBT IN AMERICA, URBAN INSTITUTE (Jul. 29, 2014), www.urban.org/publications/413191.html.

³ See, for example, *Your Rights Under the Fair Debt Collection Practices Act*, New Economy Project, <http://nedap.org/hotline/fdcpa.html>.

⁴ For a discussion of these issues, see Dalié Jiménez, D. James Greiner, Lois R. Lupica & Rebecca L. Sandefur, *Improving the Lives of Individuals in Financial Distress Using a Randomized Control Trial: A Research and Clinical Approach*, 20 GEO. J. ON POVERTY L. & POL'Y 449 (2013), available at <http://ssrn.com/abstract=2213000>.

that critical documents and evidence are never transferred.⁵ But this documentation is necessary to prove essential aspects of the account, such as the amount of principal owed, in court.

Regulators have alleged that some firms file thousands of lawsuits without evidence to support them. These lawsuits are filed in commoditized form, resulting in tens of thousands of default judgments in some states. With these default judgments against consumers in hand, the debt buyers’ attorneys collect using compulsory collection processes, such as garnishment of wages and seizures of bank accounts, enforced by overburdened courts. This narrative suggests a system rife with the opportunity for error. But is this narrative true? A rigorous examination is required.

The **Financial Distress Research Project** will provide the rigorous evidence and examination on all of the subjects just discussed. The Project is a unique partnership among multiple branches of government, academia (students and professors), multiple non-profit service providers, and the private sector. Its backbone is a gold-standard randomized control trial, resembling of the type of study the law requires before new drugs and medical devices may be sold to the public.

The Project will combine this randomized design with highly consequential credit reporting information. And it will supplement all of this information with the results of surveys and court records. The Project will include the following steps.

First, more than 75 law students, most of them volunteers, have already dedicated thousands of hours to court observations, individual interviews, and research with one goal in mind: the **production of a state of the art self-help Assistance Packet** covering how to (1) litigate a debt collection action, (2) self-diagnose on whether bankruptcy or negotiation with other creditors is the right option, (3) negotiate with

creditors (with specific materials tailored to credit card, medical, and public/private student loan debt), (4) file a successful Chapter 7 bankruptcy (including attempting to discharge student loans in bankruptcy), and (5) obtain and correct a credit report.

The Assistance Packet is focused and adapted specifically for the capabilities of its target audience, namely, persons in financial distress. Thus, it will feature cartoons (such as those above), material designed to combat feelings of shame and guilt, and small items (such as detachable post-it notes) that have been shown to aid in plan-making and follow-through.

Second, we will **begin our field operation**. Each individual who has been sued in debt collection proceedings, who calls a study-created hotline, and who otherwise meets eligibility criteria (primarily that income and assets not exceed certain ceilings), will receive limited advice and assistance over the telephone and will be asked if she would like to participate in our study.

If the individual agrees to participate, after she executes appropriate waiver and consent forms (including a consent to allow us to access credit information), **she will be randomized to one of four treatment conditions**. Depending on the group, she will be offered:

<p>Self-Help Group</p> <ul style="list-style-type: none"> ▪ Incentive, non-financial counseling⁶ ▪ Assistance Packet + telephone advice 	<p>Financial Counseling Group</p> <ul style="list-style-type: none"> ▪ Incentive, financial counseling ▪ Assistance Packet + telephone advice
<p>Lawyer Group</p> <ul style="list-style-type: none"> ▪ Incentive, non-financial counseling ▪ Offer of attorney representation⁷ 	<p>Financial Counseling and Lawyer Group</p> <ul style="list-style-type: none"> ▪ Incentive, financial counseling ▪ Offer of attorney representation

⁶ This counseling will be similar in structure to the financial counseling, but will involve non-financial content, such as cooking and nutrition. The incentive will consist of a \$50 gift card

⁷ The offer of representation will mirror the scope of the self-help packet and will thus encompass the debt collection action, negotiations with creditors, repair of credit reports, and (if appropriate and desired) a Chapter 7 bankruptcy.

⁵ See, e.g., Dalié Jiménez, *Dirty Debts Sold Dirt Cheap*, 52 Harvard J. on Legislation __ (2014), available at <http://ssrn.com/abstract=2250784>.

Third, we will **collect outcome information**. We will obtain credit scores and credit report attributes⁸ for each study participant as of three, two, and one years before entry into the study. We will also collect this information at one, two, and three years subsequent to entry.

A comparison of the financial health across our four groups will provide gold-standard evidence regarding the effectiveness of self-help packets, financial counseling, and attorney representation. We will also copy relevant court records and survey our study participants. The result will be the richest and most detailed dataset ever conducted in an evaluation of what works for individuals in financial distress. This is rigorous evidence.

In addition, our study will provide a window into the debt collection industry. Documents gained during the discovery process of litigation will shed light on how transfers of rights from credit issuers to debt buyers occur, and whether such transfers are accompanied by underlying evidence. We will also learn about the incidence, if any, of the assertions in the narrative we described above: for example, how many cases result in default judgments against consumers, how often debt buyers lack documentary evidence about the underlying debt, and how frequently consumers are unaware of available legal defenses and remedies. Examination of credit report data and court records will enable us to understand how often exempt assets and income streams are seized in these cases.

We already have preliminary **evidence that our approach works**. A parallel study in a Boston court shows that if we mail debt collection defendants a letter (with usable court forms) that deploys cartoons, simplified language, and plan-commitment materials to instill a sense of action and self-agency, we can **double the rate** at which defendants attend court to contest their lawsuits.

⁸ Credit report attributes are variables derived from the information collected by credit bureaus. They include information on bill payment history, number and type of accounts a consumer has, amount of available credit, etc.

A research effort of the complexity and importance requires many **partners**. We have obtained commitments from the nation's largest provider of financial counseling and one of the nation's three major credit reporting agencies to obtain prospective and retrospective credit report and credit score information.

We have also already secured over \$1.1 million in direct funding from the National Science Foundation,⁹ American Bankruptcy Institute, the National Conference of Bankruptcy Judges Endowment for Education, Laura and John Arnold Foundation, Abdul Latif Jameel Poverty Action Lab, Sears Fund, and a Harvard Center.

We are looking for additional funding partners, contact the research team if interested in learning more.

The Research Team

Jim Greiner is a Professor of Law at Harvard Law School. He has six years of experience as a federal court litigator and holds a Ph.D. in statistics from Harvard University. He has conducted, or is planning, eleven randomized control trials in the areas of access to justice and court administration. Contact: jgreiner@law.harvard.edu.

Dalié Jiménez is an Associate Professor of Law at the University of Connecticut School of Law. She writes about consumer law and bankruptcy. She spent a year at the Consumer Financial Protection Bureau studying issues around consumer reporting and debt collection. Contact: dalie.jimenez@uconn.edu.

Lois R. Lupica is a Professor of Law at the University of Maine School of Law. In addition to over twenty years as an academic studying bankruptcy and consumer credit, she has experience as a transactional lawyer and as an executive director of an economic development non-profit. Contact: lupica@maine.edu.

⁹ NSF award number 1423729.