Financial Education for Bankrupt Families: Attitudes and Needs

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In 2005, Congress enacted sweeping reforms to the federal bankruptcy law. A key provision of the new law requires that families who file bankruptcy must complete a financial education course before their debts may be discharged (U.S. Bankruptcy Code, 2006). This mandate has resulted in a surge in the number of families who are being exposed to formal financial education as part of the bankruptcy process. The new law provides financial educators with a unique opportunity to improve the financial knowledge and skills of these individuals.

Educators face several challenges, however, in capitalizing on this opportunity. First, for families filing bankruptcy, attendance at a financial education course is not a choice; it is a prerequisite to obtaining a bankruptcy discharge. The involuntary nature of the education may dampen debtors' enthusiasm and leave them hostile or resistant to the information provided.

Second, bankrupt families may have demographic characteristics that differentiate them from other financial education clients. Financial education programs target a wide range of audiences and adapt their subject matter and curricula accordingly (Fox, Bartholomae, & Lee, 2005). Financial education clients are frequently low-to-moderate income families with an eighth-grade reading level (Lyons, Palmer, Jayaratne, & Scherpf, 2006). In contrast, most bankrupt families have indicia of middle class status and have some college education (Sullivan, Warren, & Westbrook, 2000; Warren, 2003). Given that information asymmetries between recipients and providers can cause education programs to function inefficiently (Agarwal, Driscoll, Gabaix, & Laibson, 2007), financial educators will benefit from an awareness of how the background of bankrupt clients may affect their attitudes toward financial education.

Third, the financial needs of bankrupt families also may differ from the general population (Block-Lieb, Baron-Donovan, Gross, & Wiener, 2004). A majority of families experience financial crises before bankruptcy such as a job loss, divorce (Warren & Tyagi, 2005), or severe medical problems (Himmelstein, Warren, Thorne, & Woolhandler, 2005). Research suggests that many of these families remain plagued by financial problems even after bankruptcy (Porter & Thorne, 2006). Curricula for bankrupt families will be most relevant and helpful if they are carefully tailored to the particular needs of this group; the content of the education must respond to the realities of families' lives after they file bankruptcy.

This paper fills a gap in the literature by examining bankrupt families' attitudes toward, and need for, financial education. Our data are derived from a longitudinal study of families who filed personal bankruptcy before the law required financial education. However, their attitudes and experiences have implications for the content and delivery of the mandatory post-bankruptcy financial education. We begin by reporting the degree to which bankrupt respondents believed a financial education course would have helped them avoid bankruptcy. We then describe how the attitudes of bankrupt respondents toward financial education vary by core demographic characteristics. Finally, we identify key financial difficulties that families confront after they file bankruptcy.

Legal scholars have disagreed on whether mandatory financial education is useful to bankrupt families (Dickerson, 1999; Gross & Block-Lieb, 2005; Gross, 2005), and consumer educators have not specifically studied the unusual circumstances of bankrupt families. We assert that the potential benefits of financial education will increase if educators are aware of the attitudes and circumstances of bankrupt families. Specialized and contextualized curricula for bankrupt families are more likely to help them recover from financial collapse and achieve long-term financial well-being.

Financial Education Course Requirements

The new bankruptcy law imposes several requirements on individuals seeking bankruptcy relief. Before individuals can file bankruptcy, they must first obtain credit counseling. After they file bankruptcy, they must complete a financial education course as a prerequisite to eligibility for a discharge of their debts. This paper focuses solely on the financial education requirement that applies after bankruptcy.

Bankruptcy financial education does not rely on a standardized curriculum. While the U.S. Trustee program, a branch of the Department of Justice, must approve bankruptcy financial education providers, it has sparse evaluative criteria (U.S. Trustee Program, 2006). The U.S. Trustee program has specified only that the course should be a minimum of two hours and must cover the following generic topics: budgeting, money management, using credit, and consumer information (Gross & Block-Lieb, 2005). This limited direction means that consumer educators are chiefly responsible for the development and implementation of an effective curriculum for bankrupt individuals.

Methodology and Sample

Our data come from the Consumer Bankruptcy Project III, a three-year longitudinal study of the causes and consequences of consumer bankruptcy. In 2001, before the bankruptcy law required financial education, questionnaires were distributed to bankrupt debtors at their Meeting of Creditors, which is a mandatory aspect of every bankruptcy case. A total of 1,250 questionnaires were collected; 250 questionnaires from each of five U.S. bankruptcy districts: Central District of California (Los Angeles), Northern District of Illinois (Chicago), Eastern District of Pennsylvania (Philadelphia), Middle District of Tennessee (Nashville), and Northern District of Texas (Dallas). The sample contained Chapter 7 (liquidation) and Chapter 13 (repayment) cases in ratios that mirrored the distribution of cases by chapter in each district. The questionnaire asked debtors if, for a compensation of $50 per interview, they would be willing to complete telephone interviews over a period of several years. In early 2002, initial telephone interviews were completed with 602 of the 1,250 respondents. By late 2003 and early 2004, second interviews were completed with 474 of the 602 individuals who completed the first interview. Findings presented here rely on data from the second interviews, which were conducted approximately three years after the respondents filed bankruptcy.

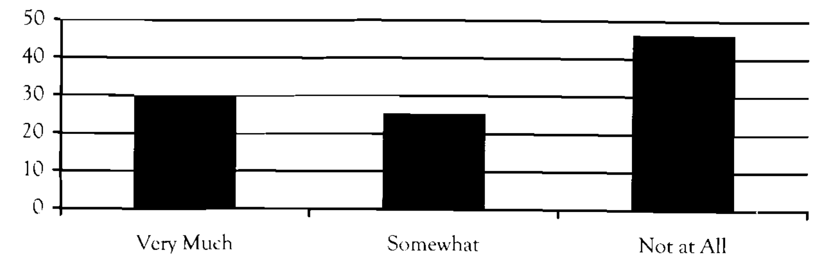
Findings

Bankrupt Debtors' Views of Financial Education

During the interviews, respondents were asked to choose from a list those things they believed would have helped them manage their financial problems. The exact query posed was: "Looking back, how much would the following things have helped you avoid bankruptcy?" One response option was "If you had taken a money or debt management course." As presented in Figure 1, 30.0% of those who responded (n=457) reported that a money or debt management course would have "very much" helped them avoid bankruptcy. Another 24.5% reported that such a course would have "somewhat" helped them. Thus, over half of the respondents (54.5%) believed that a financial management course would have "very much" or "somewhat" helped them avoid bankruptcy. These data suggest that a substantial proportion of respondents had a positive attitude about the usefulness of financial education, and are suggestive of how today's bankruptcy debtors may view the new financial education requirement. This finding should be encouraging to financial educators. Research indicates that people are more likely to improve their financial behavior if they feel that the financial education information is important, relevant, and useful (Perry & Morris, 2005).

Figure 1

Percent of bankrupt families who reported that taking a money or debt management course would have helped them avoid bankruptcy (N=457)



Attitudes toward Financial Education by Demographics

Data were analyzed to determine whether belief in the value of financial education varied by demographic variables. Respondents with lower levels of education (no college degree) were significantly ($p < 0.05$) more likely than those with college degrees to report that a financial education course would have "very much" or "somewhat" helped them avoid bankruptcy (see Table 1). While more than half (57.4%) of non-college-educated respondents indicated that a course would have been helpful, only 40.8% of respondents with at least a Bachelor's degree felt the same way. Our findings suggest that education level may be inversely correlated with a belief that financial education can help individuals avoid severe financial problems such as bankruptcy.

Our findings also reveal a significant difference ($p < 0.05$) in the age of respondents who reported that a financial education course might have helped them avoid bankruptcy. Older respondents were less likely to report that a course would have been helpful to them. While 30.0% of those under the age of 25 indicated that financial education would have "very much" helped them avoid bankruptcy, only 8.7% of respondents aged 65 years or older shared that sentiment. These results suggest that younger people may be more optimistic about the value of financial education.

Table 1
Percent of respondents who said a money or debt management course would have helped them avoid personal bankruptcy, by selected demographic characteristics (n=457)

Demographic Characteristic	Very Much	Somewhat	Not at All
Education *			
No college degree	32.8	24.6	42.6
College degree	15.8	25.0	59.2
Age *			
Under 25	30.0	25.0	45.0
25 - 44 years	35.9	23.7	40.4
45 - 64 years	22.5	25.2	52.3
65 and over	8.7	30.4	60.9
Race *			
White	22.7	25.6	51.7
Minority	38.8	23.3	37.9
Sex			
Male	27.2	23.8	49.0
Female	31.3	24.8	43.9

* Statistically significant at $p < 0.05$.

Race also was a significant factor ($p < 0.05$) in respondents' interest in financial education. More than half of white respondents reported that a financial education course would "not at all" have helped them avoid bankruptcy. In contrast, only 37.9% of respondents who were identified as members of a minority group were similarly unsure about the benefits of a financial education course.

While previous research has shown that women are more likely to manage the family's debts within financially-stressed couples (Rubin, 1976; Zelizer, 1994), we found that attitudes toward financial education did not appear to differ by gender. Women and men were equally likely to report that a financial education course could have helped them avoid personal bankruptcy.

Individuals' Post-Bankruptcy Financial Problems

During the telephone interviews, individuals were queried about their current financial situations. Research suggests that after filing Chapter 7 bankruptcy, many individuals report continued financial difficulties (Porter & Thorne, 2006). Among the 474 respondents who were interviewed, 65.0% (n=308) reported that approximately three years after filing bankruptcy they were having difficulty paying one or more of their household bills. As illustrated in Figure 2, individuals struggled most frequently with two general types of bills - those associated with maintaining a home and those related to health.

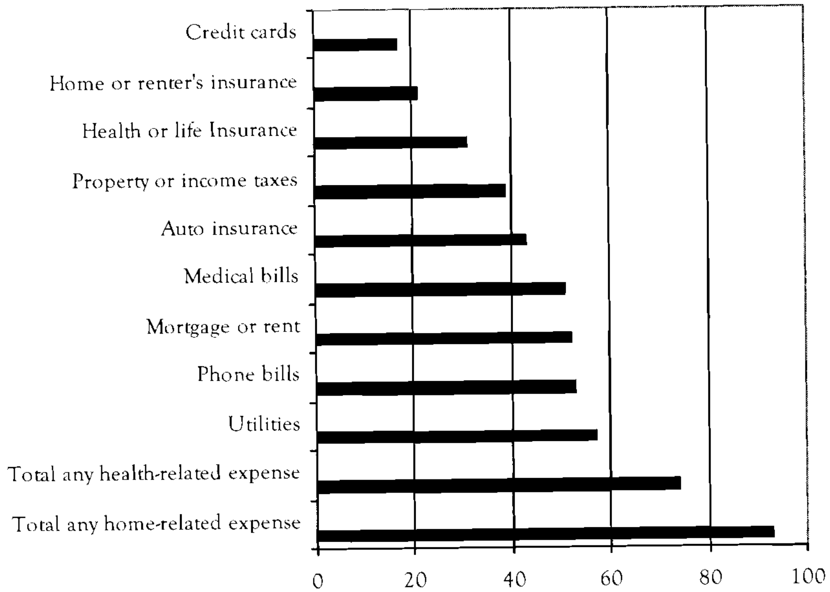
The costs associated with remaining in their homes presented a notable challenge to individuals after bankruptcy. Of the 308 respondents who were struggling to pay any type of bill, more than half (51.6%) reported that they struggled to make mortgage or rent payments. A majority of individuals also reported having difficulty paying their utility bills (56.8%) and their phone bills (52.6%). Over one-third (38.6%) struggled to pay property or income taxes, and one in five individuals (20.5%) struggled to pay homeowner's or renter's insurance. In total, 93.2% of individuals who were struggling to pay bills after filing bankruptcy had difficulties paying one or more expenses associated with the maintenance of their homes. These expenses are difficult to reduce because they are either non-discretionary or can only be lessened with a major life event such as moving from the home or combining households. However, the costs of relocating are high and families may have concerns about the effects of a school transfer on their children or the consequences of changing neighborhoods.

Difficulties in paying health-related expenses also persisted after bankruptcy. In total, 74.0% of the 308 individuals who were struggling to pay bills had difficulties paying one or more health-related expense. Half of the respondents (50.6%) confronted problems with direct expenses for medical care, including doctors' fees or prescription costs.

Health insurance can defray medical expenses and protect individuals from medical-related financial distress. If a family member dies, life insurance can be a source of income replacement. However, almost one-third (31.5%) of the

Figure 2

Types of bills individuals struggle to pay two years after filing personal bankruptcy, by percent (N=308)



individuals who were struggling to pay their bills reported having difficulties paying for health or life insurance, thereby placing them at risk for a subsequent financial catastrophe from a medical event. An even larger group of respondents (42.5%) struggled to make car insurance payments. In the event of an auto accident, a lack of insurance could result in overwhelming medical expenses or exposure to lawsuits.

In the three years following bankruptcy, respondents received numerous credit card solicitations (Thorne, forthcoming). Despite these offers, nearly half (47.5%, n=224) had no credit cards at all. Those who struggled to pay their bills were even more likely to eschew credit cards; 53.9% (n=166) did not have a card. Given these findings, it is not surprising that credit card bills troubled only 17.2% (n=53) of respondents who struggled with bills after filing bankruptcy (see Figure 2). Our data suggest that the bills

that most frequently trouble families after bankruptcy are from routine expenses (home-related or health-related) rather than credit cards.

Implications and Conclusions

Bankruptcy scholars have repeatedly documented job problems, illness and injury, and family break-ups as the most frequent triggers of financial collapse (Sullivan, Warren, & Westbrook, 2000; Warren, 2003). Despite the fact that these adverse financial events are generally beyond families' control, our findings suggest that some bankruptcy debtors believe that financial education could have helped them avoid bankruptcy. Their optimism about the value of financial education suggests that the period after filing bankruptcy may constitute a powerful "teachable moment" for financial educators.

Although a majority of bankruptcy filers (54.5%) appeared to be receptive to financial education, a substantial fraction (45.5%) believed that such a course would not have helped them avoid bankruptcy. Our analysis identified some demographic groups that may be especially resistant to financial education, such as debtors who are white, older (particularly those aged 65 and over), and college-educated. We did not find significant differences between men and women. Given our findings, educators may want to consider developing specialized curricula for bankruptcy filers in demographic groups that question the usefulness of financial education.

Financial educators may also want to tailor curricula to fit the particular financial challenges facing families that file for bankruptcy. For example, financial educators may want to advise families that they are likely to have difficulty paying routine bills. Most of these bills are non-discretionary or subsistence expenses, namely costs associated with housing and health. When instructing bankrupt families, educators may find it necessary to address the painful financial decisions that many families confront in trying to make ends meet. For instance, given the reported difficulty with household expenses, families may benefit from seeking more affordable housing by selling their homes, renting smaller residences, or sharing housing. Similarly, the finding on health-related expenses suggests that bankruptcy financial education could perhaps draw from curricula developed for those facing chronic illnesses or injuries with extensive recovery periods (Georgetown University Health Policy Institute, 2006). Educators could also help families identify government sources of support, such as prescription assistance programs or low-income housing, to use as they recover after bankruptcy.

For those financial educators determined to help bankrupt families avoid subsequent financial collapse, our findings on the affordability of insurance for families that have filed bankruptcy may be particularly alarming. While families cannot insure against all events, insurance can offer a significant safety net against unexpected expenses or income loss. Curricular exercises could help bankrupt families assess their risk for insurable events, understand the limits of their insurance coverage, and learn how to select appropriate insurance products (University of Illinois Extension, n.d.).

The U.S. Trustee program mandates that financial education courses teach consumers about the use of credit. While this is a sensible component of financial education curricula, our longitudinal data suggest that after bankruptcy, families confront a myriad of financial issues and difficulties. In particular, during the first few years after bankruptcy, it appears that families are most frequently distressed by household- or health-related expenses. Financial education can help families evaluate these expenses and consider alternatives.

In summary, providing bankruptcy financial education is a challenging task. Current law requires only a short, one-time class and provides educators with only vague direction on the topics for bankruptcy financial education. Within these constraints, financial educators have the opportunity to design an innovative curriculum that addresses the specialized financial needs of these new clients. This paper provides insight into the educational

needs of bankruptcy filers and identifies particular subgroups that may be more or less receptive to financial education. When financial educators are armed with information about bankrupt families' attitudes toward financial education and their post-bankruptcy financial difficulties, they can more effectively help their clients recover after bankruptcy and avoid future financial problems.

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