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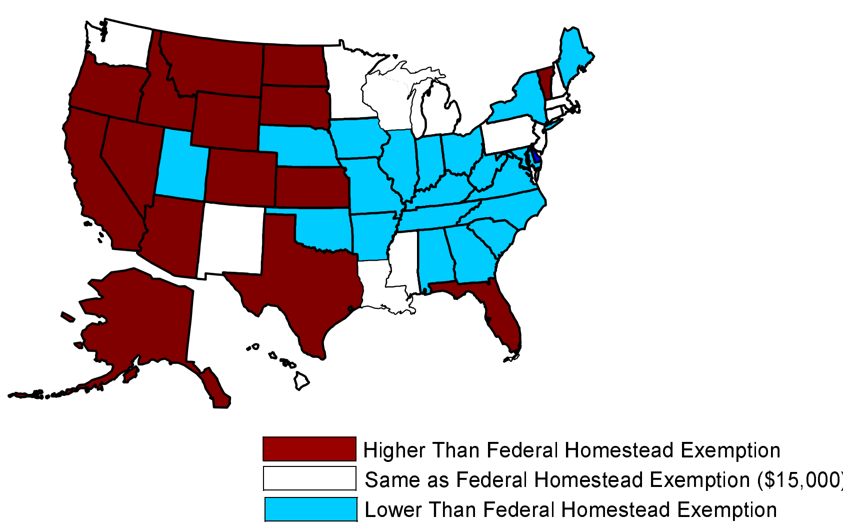
The Influence of Legal Factors on Personal Bankruptcy Filings

Current calls for reform of U.S. bankruptcy law reflect the widespread belief that the legal framework influences individual decisions to file for personal bankruptcy and, therefore, the rate of filings. This paper explores the relationship between legal factors and the incidence of personal bankruptcy. Casual observation suggests that the sharp rise in the rate of personal bankruptcy filings over the past 20 years has coincided with significant events that have changed the legal environment. Further analysis of differences in the legal environment and filing rates at the state level provides a stronger test of the influence of legal factors. The paper finds that the level of assets exempted from bankruptcy does not appear to explain state differences as one might expect but that differences in wage garnishment laws do appear to influence bankruptcy filings.

The Differences in Homestead Exemption Levels Are One of the Factors Often Cited for the Increase in Personal Bankruptcy Filings



Source: FDIC Legal Division

The Influence of Legal Factors on Personal Bankruptcy Filings

High and rising bankruptcy rates in the U.S. are a concern because of the close relationship between personal bankruptcies and consumer loan losses. The personal bankruptcy rate has risen consistently from under 1.0 per thousand population annually in the early 1970s to over 4.7 per thousand for the year ending June 30, 1997. Recent research has looked at bankruptcy filings over time at both the U.S. and state level.

Bishop (1998) examines time series relationships at the U.S. level. His study attempts to quantify the influence that the consumer debt burden and the business cycle have on the nonbusiness bankruptcy rate. He concludes that the consumer debt burden and the business cycle explain approximately two-thirds of the variation in the national nonbusiness bankruptcy rate. However, his out-of-sample forecasts show that other factors also are at work. He asserts that changes in consumer behavior might also play a role. Bishop recommends that additional research be done in several areas, including the impact of changes in the legal environment at the national and state level, to determine the impact of changes in behavior.

Brown (1998) looks at how state bankruptcy rates have moved over time. His statistical analysis shows that the forces pushing bankruptcy rates upward over the past 25 years have operated in a relatively uniform manner across the nation. His model indicates that just under one-half of the total variation across states and over time is explained by the national trend alone. Brown also concludes that the differences in bankruptcy rates across states are large relative to the U.S. rate and are persistent over time. Furthermore, there is a relatively stable rank ordering among individual state rates over time. He suggests that the stable ranking is attributable to institutional factors, such as legal and demographic differences among states, because these factors are unique to particular areas and change slowly, or not at all, over time.

The Role of Legal Factors in Individual Financial Risk Management

Legal factors establish a risk-and-reward framework for many decisions involving individual financial risk management. They can influence how a creditor and debtor react to financial difficulties, up to and including the decision to file for bankruptcy. Therefore, when changes in law alter the risk and reward framework, there is the potential that the changes can contribute to new trends in bankruptcy filings.

Laws often reflect the collective values of a locale, and because states have discretion to pass their own laws in many areas, the risk-and-reward framework can differ among states. For example, some states have passed laws requiring certain types of insurance that limit the amount of financial risk an individual takes on. Other states limit or extend the remedies a creditor can apply when a debtor defaults on an obligation. States also differ as to how much of a debtor's assets will be protected in a bankruptcy filing. Gropp, Scholz, and White (1997) found that state personal bankruptcy exemptions affect the supply and demand for credit and benefit high-asset households the most.

Legal Factors Operating at the National Level

The past two decades have been marked by a steadily rising U.S. personal bankruptcy rate. Many reasons have been given for the rise, including the large amount of debt held by households, aggressive marketing to households by credit card companies, and a lessening of the stigma formerly associated with filing personal bankruptcy. The prevalence of legal advertising on television and changes in federal bankruptcy laws also are factors frequently cited in explaining the long-term rise.

For the most part, federal law governs bankruptcy proceedings. The basic model for the law has remained the same over time; it is an asset-based model rather than an income-based model.[1] That is, the bankruptcy system generally has been used to liquidate a debtor's assets and distribute them to creditors at the time of filing rather than to manage the debtor's future income for the benefit of creditors. Chapter 7 of the bankruptcy code seeks to liquidate and distribute a debtor's assets at the time of the bankruptcy filing, and approximately 70 percent of all nonbusiness bankruptcies are filed under Chapter 7. The bankruptcy code affords debtors the option to pay creditors out of future income through Chapter 13 of the code; however, this option is voluntary and not available to all debtors. The law seeks to achieve a balance between the interests of the debtor and those of the creditors; however, any revisions made to the code may give the appearance of favoring one party.

In the past two decades, at least three events have altered the legal framework at the national level and may have contributed to the long-term rise in the U.S. personal bankruptcy rate. The first event is a Supreme Court decision in 1977 that paved the way for lawyers to advertise on television. The other two events are revisions to the bankruptcy code that have the appearance of favoring debtors. Other revisions have been made to the bankruptcy code, but these two changes are focused on in this analysis because they would most likely make bankruptcy more attractive to a debtor and therefore contribute to a rise in the number of filings.[2]

Bates Versus *State Bar of Arizona*, 1977

In the 1977 case of *Bates* v. *State Bar of Arizona*, the Supreme Court held that advertising by attorneys was entitled to "free speech" protection under the U.S. Constitution as long as the advertising was not misleading. This decision removed state prohibitions on attorney advertising; in 1980, three years after that ruling, approximately $5 million was spent for legal advertising on television. Since then, the growth in expenditures has been dramatic. In 1994, approximately $129 million was spent on advertising for legal services on television.

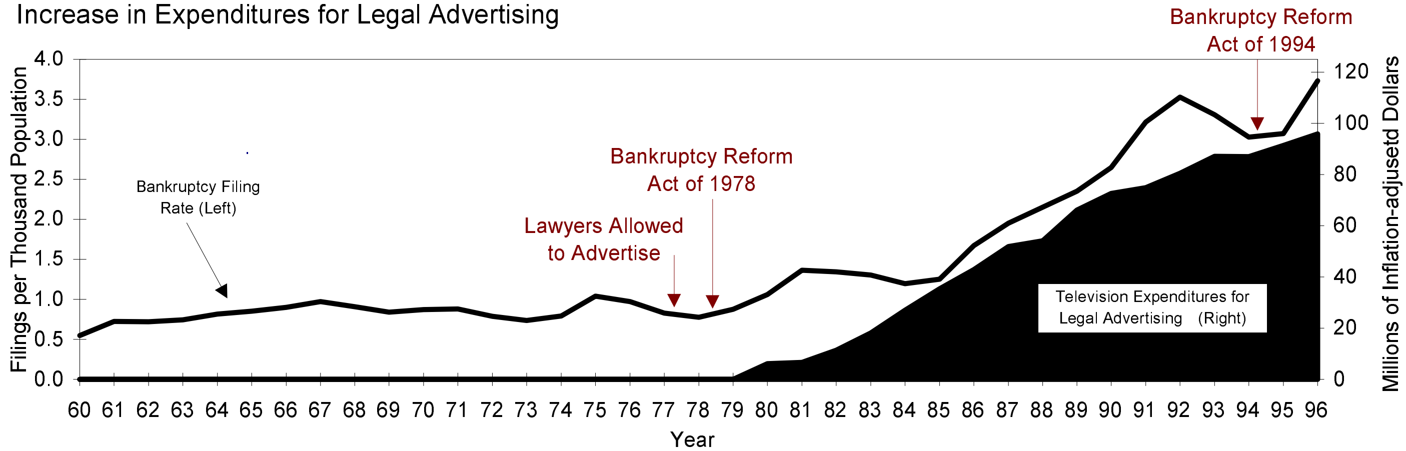
Legal advertising is thought to have some effect on the overall level of bankruptcy rates, because it educates consumers about bankruptcy and promotes bankruptcy as an accessible means for solving financial difficulties. It also may diminish some of the stigma of bankruptcy by making it more a part of the public consciousness.

Bankruptcy Reform Act of 1978

The Bankruptcy Reform Act of 1978 established the current federal bankruptcy code. It was the first piece of bankruptcy legislation passed since the Bankruptcy Act of 1898. Under the 1978 Act, discharge - that is, dismissal of a debtor's financial obligations - was made readily available with a number of excepted debts. Federal asset exemption levels also were established. The new federal levels were higher than many of the state levels, but states were given the right to opt out of the federal exemption scheme and provide their own

Chart 1

The Rise in Personal Bankruptcy Filings Corresponds With Changes in Bankruptcy Law Favoring Debtors and an Increase in Expenditures for Legal Advertising



Source: Administrative Office of the U.S. Courts, Census Bureau, and Statistical Abstract of the U.S.

*1995 and 1996 are estimates.

scheme. The 1978 Act also sought to encourage partial repayment of debt through the use of the new Chapter 13.

Bankruptcy Reform Act of 1994

The Bankruptcy Reform Act of 1994 made Chapter 13 filings more accessible and attractive compared with Chapter 7 filings, in part by expanding eligibility. It also doubled the dollar amounts for exempt property in Chapter 7 under the federal plan. However, the effect of this adjustment is somewhat diminished, as 36 states have chosen to opt out of this federal plan and establish their own exemption levels. Also, the increase in exemption levels may not have provided that much of an economic benefit because inflation caused consumer prices to more than double between 1978 and 1994.

Effect of U.S. Legal Changes

These three legal events are plotted on Chart 1 as points along the graph of the U.S. bankruptcy rate from 1960 to 1996. As the chart shows, the 1977 court ruling and the Bankruptcy Reform Act of 1978 closely preceded a significant rise in the U.S. per capita bankruptcy filing rate. Bankruptcy rates also rose sharply after passage of the Bankruptcy Reform Act of 1994; however, it may be too soon to assess the long-term impact of this legislation.[3] These legal events appear to coincide with the rise in the U.S. personal bankruptcy rate; however, it is difficult to determine causality from this chart. These events are one-time changes, and a number of other coincident factors may be operating over the time period.

Legal Factors Operating at the State Level

Another way to evaluate the effect of legal factors on personal bankruptcy rates is to explore the relationship at the state level.[4] There is no way to test the effect of legal advertising on state bankruptcy rates because of a lack of data on the volume of advertising in each state. However, it is possible to test the effect of the increased federal exemption levels, because asset exemption levels vary across the states. This analysis represents a stronger test than the analysis done at the national level because of the larger number of observations. In addition to asset exemption levels, four other state legal factors thought to influence the incidence of personal bankruptcy are used in this analysis.

Strategy

Brown (1998) identified 16 states for which bankruptcy filing rates were persistently above or below the national average. These states comprise the sample for this analysis. Of the 16 states, 6 have bankruptcy rates that are considerably higher than the national average and are trending upward at a faster rate. These "high bankruptcy states" are Alabama, California, Georgia, Mississippi, Nevada, and Tennessee. Ten of the 16 states have bankruptcy rates that are considerably below the national average and trending upward at a slower rate than the national average. These "low bankruptcy states" are Alaska, Delaware, Hawaii, Maine, Massachusetts, North Dakota, Pennsylvania, South Carolina, South Dakota, and Vermont. These 16 states were not chosen randomly, but they represent a reasonable sample for this analysis because they are states at the opposite ends of the spectrum. They are states with the fastest or slowest rising bankruptcy rates, so if legal factors influence the incidence of personal bankruptcy, these factors certainly should be at work in these states.

Legal Factors Reviewed

Five legal factors are described and analyzed in the following sections to assess the overall contribution of legal factors to differences in state bankruptcy filing rates. These factors are automobile insurance laws, wage garnishment laws, foreclosure proceedings, asset exemption levels, and divorce settlement laws. In each section below, the nature of the law is described and a hypothesis is laid out describing what the expected outcome is for both high bankruptcy states and low bankruptcy states. The tables in each section illustrate the results of the analysis. The shaded areas in the tables include the states that fit the expected outcome, and the unshaded areas contain the anomalies.

Automobile Insurance Laws. Automobile accident is often cited as a cause of personal bankruptcy. A motorist responsible for an automobile accident in which damages are high may experience economic disaster if he or she did not have automobile insurance or if insurance coverage was inadequate. States have financial responsibility laws requiring that a licensed driver or registered owner of a motor vehicle to maintain some form of financial responsibility to cover the driver in case of an accident. This requirement generally takes the form of either self-insurance or a liability insurance policy. Some states require that a person furnish proof of financial responsibility only after being involved in an accident. Other states require proof of financial responsibility as a precondition to obtaining a driver's license or vehicle registration.

These laws have the effect of limiting the amount of financial risk a motorist can assume. The expectation in this case is that states with strict requirements for financial responsibility may experience lower rates of personal bankruptcy than states in which there are no requirements to furnish proof of financial responsibility before registering a vehicle or obtaining a driver's license. SMR Research Corporation (1997) studied the effect of auto insurance laws on bankruptcy rates and found that the correlation between the two is generally strong at the state level.

Table 1 shows the results of the analysis of financial responsibility laws for states in the sample. The expected outcome applies to 13 of the 16 states. Three of the states with high bankruptcy rates have no requirement for proof of financial responsibility before registering a vehicle or obtaining a driver's license, and all of the states with low bankruptcy rates have some form of financial responsibility requirement. Only three states are anomalies. These states have financial responsibility requirements and also have high bankruptcy rates.

Although the number of states that fit the expected outcome is high, there are noteworthy exceptions. In particular, Georgia requires automobile insurance but nevertheless has the second highest per capita bankruptcy rate in the nation. The particular exceptions in this case indicate that automobile insurance laws are not an overriding legal factor driving bankruptcy rates in all states.

Garnishment Laws. Wage garnishment is a process used by many lenders to collect loans from delinquent borrowers. Garnishment is a postjudgment debt-collection procedure. It involves the issuance of a process to a third party (the garnishee) who is holding property or money owed to the debtor in order to compel that property or money be applied in reduction of the garnishing creditor's claim.

Studies on the effect of wage garnishment laws have found that states that make it easier for a debtor's assets to be garnished have higher bankruptcy rates. For example, in early 1997, *USA Today* reported that the more wages are protected from garnishment in a state, the lower the bankruptcy rate Albert, 1997). The explanation is that the onerous effects of garnishment push debtors into bankruptcy as a form of relief. Staff from the Division of Insurance talked to bankruptcy professionals across the country to learn more about the reasons for the rising trend in personal bankruptcies. One person in South Carolina reported that one of the reasons South Carolina's bankruptcy rate was lower than neighboring Tennessee's is the more liberal wage garnishment laws in Tennessee. Another bankruptcy professional also mentioned wage garnishment and attachment laws as a long time driving factor in Tennessee personal bankruptcies.

Table 1

Severity of Automobile Insurance Laws Appears to Correlate With State Bankruptcy Rates ... But Not in Every Case

State Automobile Insurance Law	High Bankruptcy States	Low Bankruptcy States
Insurance Not Required	Alabama Mississippi Tennessee	
Insurance Required	California Georgia Nevada	Alaska Delaware Hawaii Massachusetts Maine North Dakota Pennsylvania South Carolina South Dakota Vermont

Source: SMR Research Corporation

Table 2

Amount of Wages and Income Exempt in a Garnishment Proceeding Appears to Explain Much of the Difference in State Personal Bankruptcy Rates

Wages and Earnings Exempt	High Bankruptcy States	Low Bankruptcy States
Less than 75% of wages or disposable earnings are exempt	California	Alaska Massachusetts
75% of wages or disposable earnings are exempt	Alabama Georgia Mississippi Nevada Tennessee	Maine North Dakota Vermont
More than 75% of wages or disposable earnings are exempt		Delaware Hawaii Pennsylvania South Carolina South Dakota

Source: FDIC Legal Division

The effect of wage garnishment laws on state bankruptcy rates can be seen in Table 2.[5] Many of the states in the sample exempt 75 percent of an individual's wages or disposable earnings from garnishment. These states are in the middle row of the table. States that exempt more than 75 percent of a debtor's income from wage garnishment are considered to be "debtor-friendly," and these states are in the bottom row. States that exempt less than 75 percent of a debtor's income from wage garnishment are considered to be "creditor-friendly," and these states are in the top row.

None of the high bankruptcy states are debtor-friendly states. Most of the high bankruptcy states exempt 75 percent of wages or disposable income, and California even ranks as a creditor-friendly state. Five low bankruptcy states are debtor-friendly states. Pennsylvania and South Carolina, along with Texas and North Carolina (states not in the sample), do not allow any form of wage garnishment except in the case of alimony or child support. Alaska and Massachusetts are the only anomalies in this case because they are creditor- friendly states yet have low bankruptcy rates. In general, the results of this sample appear to show a good fit between state garnishment laws and the incidence of personal bankruptcy.

Another factor governing the financial burden of a garnishment proceeding is its duration. A continuous garnishment stays in effect until the debt has been paid

Table 3

Duration of a Garnishment Proceeding Does Not Appear to Be a Factor in Personal Bankruptcy Rates

Duration of Garnishment	High Bankruptcy States	Low Bankruptcy States
Continuous	Georgia Nevada Tennessee	North Dakota South Dakota
Consecutive	Alabama California Mississippi	Alaska Delaware Hawaii Maine Massachusetts Pennsylvania South Carolina Vermont

Source: FDIC Legal Division

in full. However, some states require the judgment creditor to use consecutive garnishments for the collection of the same debt. The expectation in this case is that creditors who are required to use consecutive garnishments may determine that it is not profitable to do so. Since creditors are typically trying to recover relatively small dollar amounts with a wage garnishment, it may not be profitable to file successive wage garnishments and incur legal and other administrative expenses.

The findings summarized in Table 3 (previous page) do not shed much light on the effect of the duration of a garnishment on state bankruptcy rates. High bankruptcy states are split evenly between states that allow continuing versus consecutive garnishments. More low bankruptcy states require consecutive garnishments be filed, which does fit the expectation. The duration of wage garnishment proceedings does not appear to be as strong a factor as the amount of wages or disposable earnings that are exempt from a garnishment.

Foreclosure Proceedings. The ease with which creditors can obtain title to collateral through foreclosure is another factor that might influence the decision to file for bankruptcy. Foreclosure of real estate is a lender remedy that is governed by state law. "Judicial foreclosure" refers to the process of foreclosing a mortgage or deed of trust through a court proceeding. "Nonjudicial foreclosure" refers to the process of invoking a "power of sale" clause in a mortgage or deed of trust without resort to a court proceeding. Judicial foreclosure is available in all states, but some states recognize nonjudicial foreclosure as well.

Lenders often see the nonjudicial process as advantageous because it is quicker than a judicial process. The expectation in this case is that states that allow nonjudicial foreclosure might experience higher bankruptcy rates than states that do not allow this process, because debtors would be confronted with losing a significant asset more quickly. States that allow a nonjudicial process are considered creditor-friendly states, and states that do not allow a nonjudicial process are considered debtor-friendly states.

The results shown in Table 4 uphold our expectation for 11 of the 16 states. All but one of the high bankruptcy states are creditor-friendly states and allow a nonjudicial foreclosure process. Results for the low bankruptcy states are mixed. Four of these states are anomalies because they are creditor-friendly and allow a nonjudicial foreclosure process, yet they are still low bankruptcy states.

Bankruptcy Exemption Levels. Federal law defines the type and amount of assets a debtor can keep, or exempt from liquidation for repayment of debts, in a Chapter 7 bankruptcy filing. For example, the federal bankruptcy code allows $15,000 of a debtor's homestead to be exempt from liquidation. However, states are allowed to opt out of the federal exemption levels and establish their own. Thirty-six states have opted out, and these states require their residents to comply with their state's exemption levels see chart on front cover .

The expectation in this case is that states with higher asset exemption levels, allowing debtors to keep more property after filing Chapter 7, will have a higher

Table 4

Most of the High Bankruptcy States Have a Nonjudicial Foreclosure Process

State Foreclosure Process	High Bankruptcy States	Low Bankruptcy States
Nonjudicial Allowed	Alabama California Georgia Mississippi Tennessee	Hawaii Maine Pennsylvania South Dakota
Nonjudicial Not Allowed	Nevada	Alaska Delaware Massachusetts North Dakota South Carolina Vermont

Source: FDIC Legal Division

incidence of personal bankruptcy. It would be more appealing to file for bankruptcy in these states than in states with lower asset exemption levels, under which a debtor would be forced to give up more property to repay creditors.

States with lower asset exemption levels are considered to be creditor-friendly, because more of a debtor's assets are liquidated to repay debts. However, unlike the previous scenarios, a creditor-friendly state in this scenario is less likely to induce personal bankruptcy because the debtor would have less incentive to declare. States with higher asset exemption levels are considered debtor-friendly states because less of a debtor's assets would be liquidated to repay debts. However, this situation is more likely to be associated with increased rates of filing because debtors would find it more attractive to file.

Table 5 shows that 12 of the 16 sample states have opted out of the federal exemption levels. Six of the states opting out have established homestead exemption levels that are lower than the federal level and thus are creditor-friendly states.[6] The other six states opting out have established homestead exemption levels that are higher than the federal level and are debtor-friendly states. The table does not show any systematic pattern that would indicate a close relationship between homestead exemption levels and the incidence of personal bankruptcy.

It is also interesting to note the cases of Florida and Texas, two states not in the sample. These two states are widely known for having generous homestead exemption levels but would not fit the expectation because they have personal bankruptcy rates that are relatively low compared with the national average. Shiers and Williamson (1987) found a similar result. Their explanation of this seeming contradiction was that lenders in these states compensate for high asset exemptions through lending standards. Their study concluded that state laws regarding exemption levels serve as a substitute for the resources that lenders devote to reducing the risk of default on loans. The reasoning is that it is less costly to make bad loans in low exemption states than it is in high exemption states because the debtors will be less likely to file for bankruptcy. Consequently, lenders in low exemption states devote fewer resources to risk-reduction activities and make more bad loans.

Alimony and Property Division in Divorce Proceedings. Divorce is another factor commonly cited as a cause of personal bankruptcy. SMR Research Corporation (1997) found that bankruptcy rates tend to rise with divorce rates at the county level. One reason is that a couple's housing costs can double after a divorce without any increase in income. Divorce can cause other financial problems, such as situations in which, under the divorce judgment, large debts formerly handled by the couple together are heaped on one spouse more than the other. The adverse effect of divorce also can be a more long-term one when a spouse falls behind in alimony or child support payments and is later faced with a legal judgment to pay.

Laws in each state govern the distribution of assets and the payment of alimony in a divorce proceeding and

Table 5

Homestead Exemption Levels Do Not Explain Differences in State Bankruptcy Rates

	High Bankruptcy States	Low Bankruptcy States
Opted Out and Exemptions are Higher	California Mississippi Nevada	Alaska North Dakota South Dakota
Utilizes Federal Scheme		Hawaii Massachusetts Pennsylvania Vermont
Opted Out and Exemptions Lower	Alabama Georgia Tennessee	Delaware Maine South Carolina

Source: FDIC Legal Division

might influence the financial repercussions of a divorce action. Two of the sample states, California and Nevada, are community property states. Laws define community property as all property acquired by either or both spouses during the marriage as a result of their labors. Both spouses are considered equal owners of community property regardless of which spouse actually "earned" it. Separate property is either property owned by a spouse before marriage or property acquired by gift or inheritance. In California, courts must make an "equal" division of property, while courts in Nevada must make an "equitable" division of property.

Of the non-community-property states, most fall under either a dual-property scheme or an all-property scheme. A dual-property scheme is similar to a community property system. An all-property scheme allows the courts to divide all property of the spouses at divorce, regardless of its source. Alaska has a mixed scheme in which only marital property is divided at divorce, unless the judge believes that this type of property division would be unfair.

The nature of state laws in this area makes it difficult to hypothesize about how these laws might influence a state's bankruptcy rate. Furthermore, while most of the laws govern the distribution of assets and the payment of alimony, the courts generally are given wide latitude in deciding who should be responsible for debts. Distribution of the debts is probably a more significant factor in a former spouse's eventual bankruptcy. It also should be noted that even if a divorce court rules that one spouse is solely responsible for a joint debt, that ruling does not prevent a creditor from seeking remedy from both spouses should default occur. These limiting factors notwithstanding, the divorce settlement laws were reviewed for each of the sample states to determine whether a pattern exists between these laws and bankruptcy rates.

Table 6 shows results of the analysis. One pattern is that all of the high bankruptcy states have community property or dual-property systems, except for Georgia and Mississippi. The laws in Georgia and Mississippi cannot be classified according to any of these systems (see footnote to Table 6). For the low bankruptcy states in the sample, the results are mixed. These states are fairly evenly distributed between community property or dual-property and all-property or mixed systems. Generally, no conclusion can be made as to the effect of divorce settlement laws on state bankruptcy rates.

Conclusion

It is widely agreed that the legal framework influences individual decisions to file personal bankruptcy and therefore influences the rate of filings. Recent research on bankruptcy filings at both the national and state level has suggested that legal factors might be a factor in the increase in personal bankruptcy. This paper extends those analyses.

Legal factors operating at the national level that are thought to influence the incidence of personal bankruptcy include changes in the federal bankruptcy code and an increase in lawyer advertising on television. A review of these factors indicates that two changes to the federal bankruptcy code that increased exemption levels, and a legal ruling allowing television advertising

Table 6

Divorce Settlement Laws Don't Appear to Drive State Bankruptcy Rates

State Exemption Level	High Bankruptcy States	Low Bankruptcy States
Community Property or Dual Property	Alabama California Nevada Tennessee	Delaware Maine Pennsylvania South Carolina
All Property or Mixed		Alaska Hawaii Massachusetts North Dakota South Dakota Vermont

*Note: The states of Georgia and Mississippi cannot be classified according to these schemes. In Georgia, courts are empowered to distribute property at divorce as a part of the power to make an alimony award. Mississippi has no statue, but courts appear to distribute property according to how title is held.
Source: FDIC Legal Division

by lawyers, occurred coincident with a long-term rise in the national bankruptcy rate. However, it is difficult to establish a causal relationship between legal factors and bankruptcy through U.S. aggregate data alone.

Zandi's 1997) comparison of the U.S. and Canadian personal bankruptcy rates suggests that changes to the U.S. federal bankruptcy code have contributed little to the rise in filings. As in the U.S., Canadian personal bankruptcies began to rise quickly in 1995 and have risen by nearly as much as U.S. bankruptcies; however, there have been no significant recent changes to Canada's bankruptcy laws.

This paper has looked at some of the same factors through a comparison of legal frameworks and filing rates across states. Many of the state legal factors appear to influence state bankruptcy rates in the expected manner; however, there are exceptions to the expected outcome in all cases. None of the legal factors appears to be a sole, or even dominating, factor in the incidence of personal bankruptcy across all states. There were so many exceptions in the analysis of asset exemption levels that this factor does not appear to explain the incidence of personal bankruptcy at all.

However, certain legal factors do appear to explain some of the differences in bankruptcy rates across states, particularly the laws relating to lender remedies. The laws that delineate the amount of wages or disposable earnings exempt from wage garnishment had the fewest number of exceptions in this analysis.

Perhaps the conclusions of this analysis can be illustrated most clearly by citing the examples of Tennessee, Georgia, and South Carolina. Tennessee and Georgia consistently have the top two highest bankruptcy rates in the county, but their neighboring state, South Carolina, consistently has one of the lowest rates in the country. Both Tennessee and Georgia allow a continuous wage garnishment process and allow 25 percent of a debtor's wages or disposable earnings to be garnished. There also is a nonjudicial foreclosure process in both states. However, South Carolina does not allow any type of wage garnishment except for child support and does not have a nonjudicial foreclosure process. Lenders are able to exert a considerable amount of pressure on delinquent borrowers in both Tennessee and Georgia, but in South Carolina, the laws favor the debtors. These discrepancies may go far in explaining why debtors are more likely to seek bankruptcy protection in Tennessee and Georgia than in South Carolina.

Endnotes

[1] The author acknowledges the valuable contribution of Jerilyn Rogin, Senior Attorney, FDIC Legal Division, who provided a written history and theory of consumer bankruptcy laws used in this analysis.

[2] The Bankruptcy Amendments and Federal Judgeship Act of 1984 contained several provisions concerning consumer debts for which the consumer credit industry lobbied. Overall, these amendments tightened the reins on consumer debtors; they were Congress's reaction to the industry's allegations that individual consumer debtors were abusing the bankruptcy laws. These amendments would not make bankruptcy more attractive to a debtor.

In 1986, the Bankruptcy Code was amended again by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986. At the urging of the consumer credit industry, the United States Trustee was added as a person who could move for dismissal of a Chapter 7 case for substantial abuse under section 707(b) of the Code. This change to the bankruptcy code would not necessarily make bankruptcy a more attractive option to the debtor.

In 1990, Congress enacted the Taxpayer Recovery Act as part of the Comprehensive Crime Control Act. This law contained a number of amendments to the Code intended to prevent persons who committed fraud upon financial institutions from using the Code to escape their liability to banking agencies. Two other laws were passed that year that placed further limitations on debts eligible for discharge, including student loans, criminal restitution obligations, and death or personal injury debt. These laws also are less favorable to the debtor and would not make bankruptcy more attractive.

[3] If the 1994 Act intended to encourage the use of Chapter 13 over Chapter 7, it has not yet achieved its intended result. While the overall number of bankruptcy filings has risen, the proportion of bankruptcy filings is approximately 70 percent for Chapter 7 and 30 percent for Chapter 13, which is the same approximate mix that has existed over the past two decades.

[4] The author acknowledges the valuable contribution of Thomas Bolt, Counsel, FDIC Legal Division, who provided a written summary of state laws used in this analysis.

[5] Garnishment laws differ among the states in the property subject to garnishment and the property exempt from garnishment. Each state has a slightly different law in this regard. This analysis focuses on only the wages or disposable earnings that can be garnished, because it was thought that differences in other areas of garnishment law would most likely not be such strong drivers in aggregate levels of bankruptcy filings.

[6] To determine whether state exemptions were higher or lower than federal exemptions, emphasis was placed on the state's level of homestead exemptions. It was assumed that for a debtor wanting to protect assets, in the majority of cases a homestead would be the most valuable asset the debtor would try to protect.

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