The Bankruptcy Landscape Today

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Outline

- Liability structure of consumer bankruptcies: how large are tax liabilities?
- How has COVID-19 recession affected bankruptcy rates?
- Intersection of tax incentives and restructuring moving forward

Structure of Liabilities

Consumer liabilities

Average Ch. 7

- Secured: 39.8%
- Unsecured Priority: 1.6%
- Unsecured: 58.6%

Average Ch. 13

- Secured: 62.3%
- Unsecured Priority: 2.5%
- Unsecured: 35.1%

Median (Average) Debt Amounts

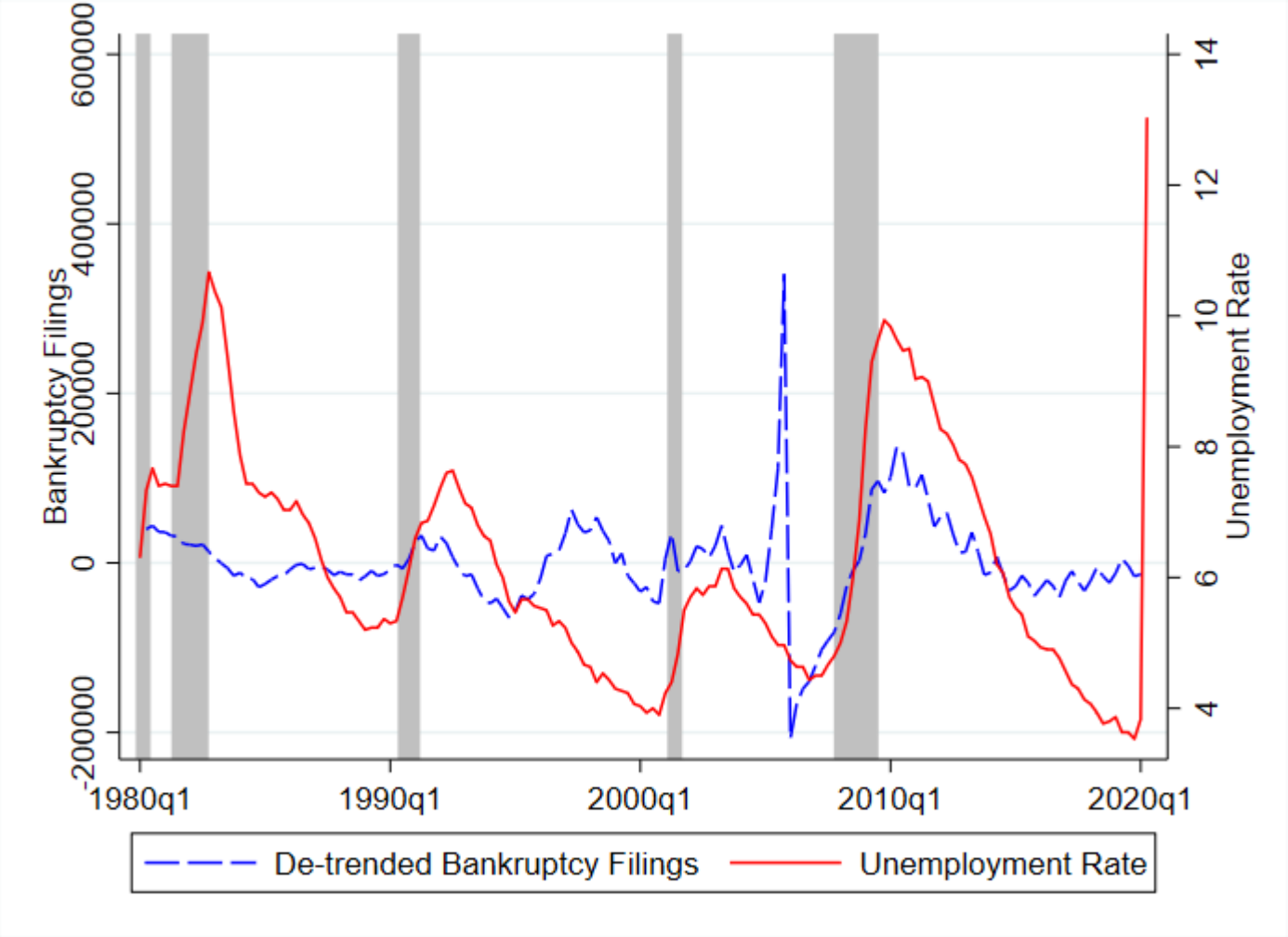
- Secured: $26,762 ($127K)
- Unsecured Priority: $0 ($4k)
- Unsecured: $47,019 ($116k)

Median (Average) Debt Amounts

- Secured: $152K ($192K)
- Unsecured Priority: $0 ($4k)
- Unsecured: $38K ($60K)

Bankruptcy Trends
During COVID-19 Recession

Bankruptcies Are Counter-Cyclical, Correlated With Unemployment

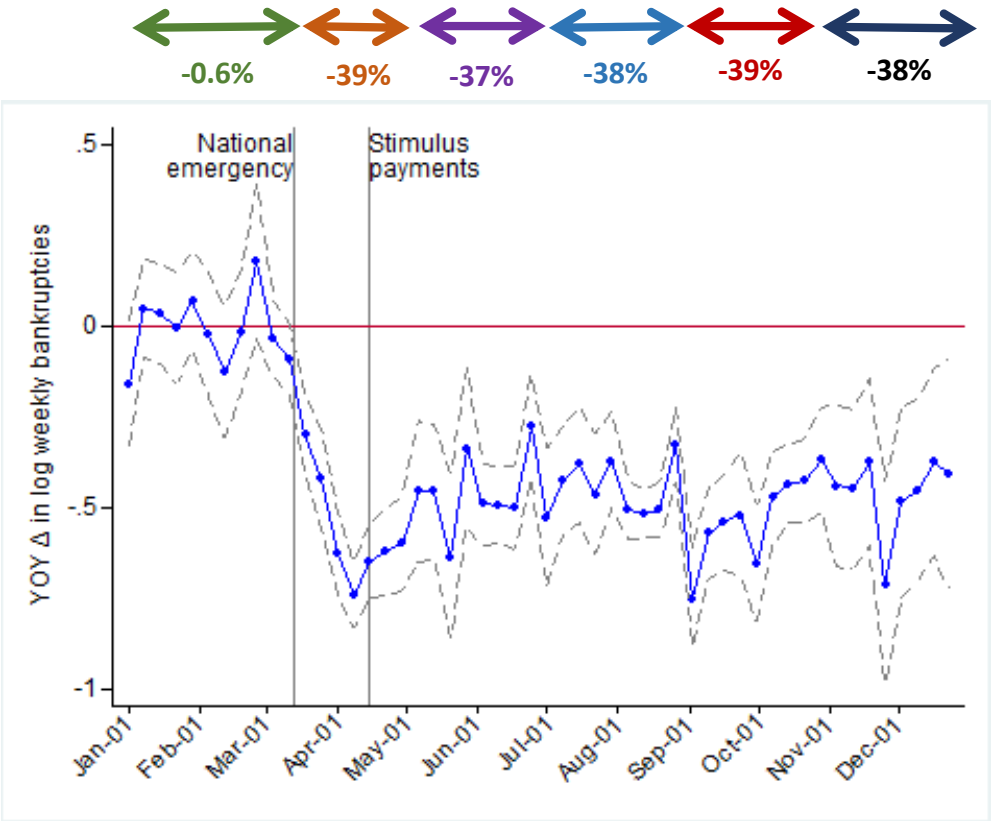


Correlation: 0.54

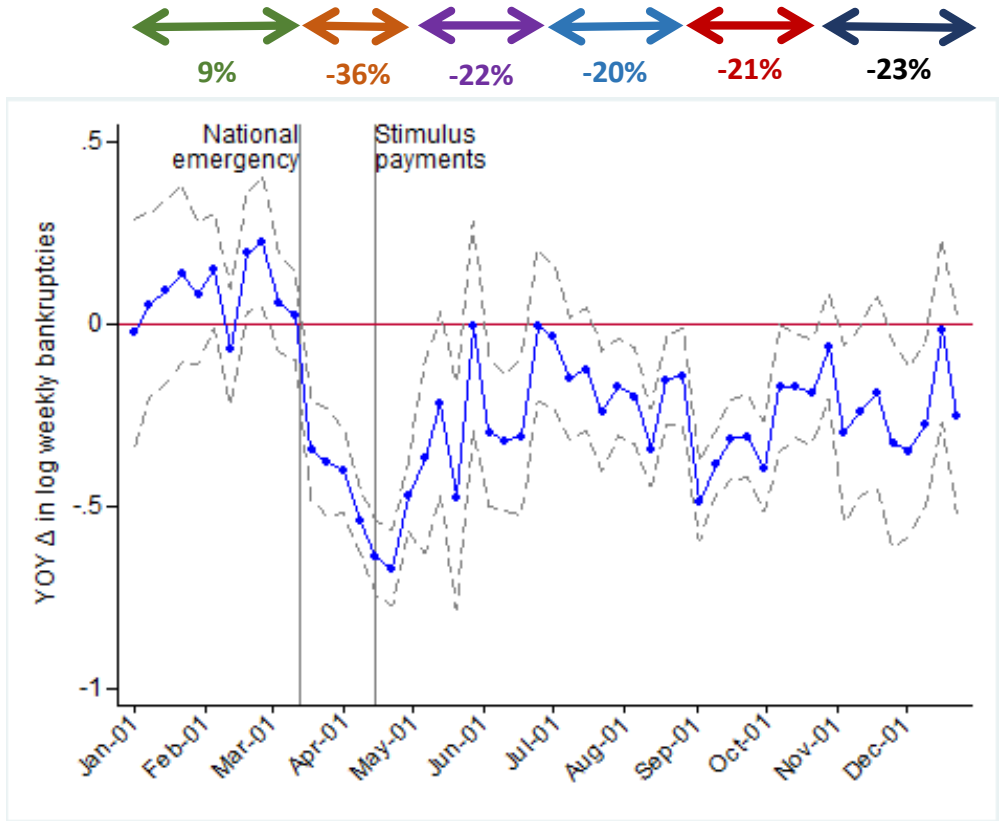
Especially strong correlation in GFC

Bankruptcies Dropped Significantly Starting In Mid-March

Consumer (-31% YOY)



Business (-17% YOY)



Regression coefficients with seasonal controls based on 2019

Key Dates

1/20 – First COVID case

3/13 – National Emergency

3/16 – 3/23: Court Shutdowns

3/27 – CARES Act Signed

4/15 – Stimulus Payments

4/3 & 27 – PPP

7/24-26 – Eviction moratoria, enhanced UI expired

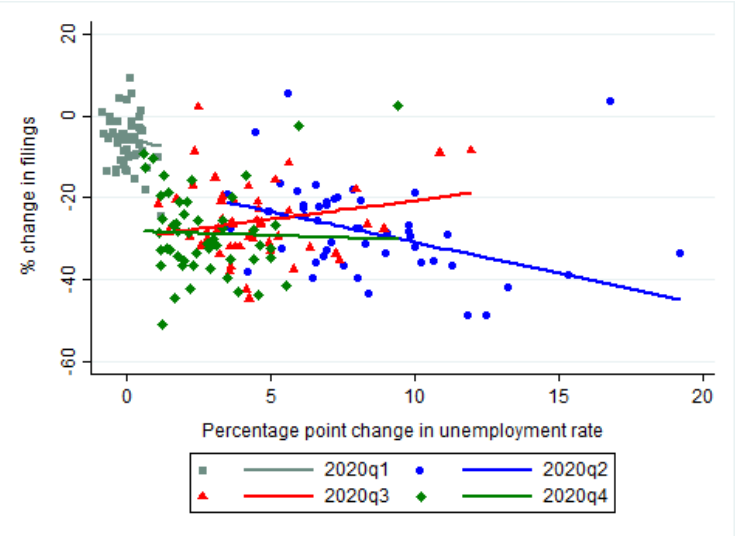
Higher Unemployment → Greater DECLINE in Bankruptcies

X-axis:
Percentage point Δ unemployment rate

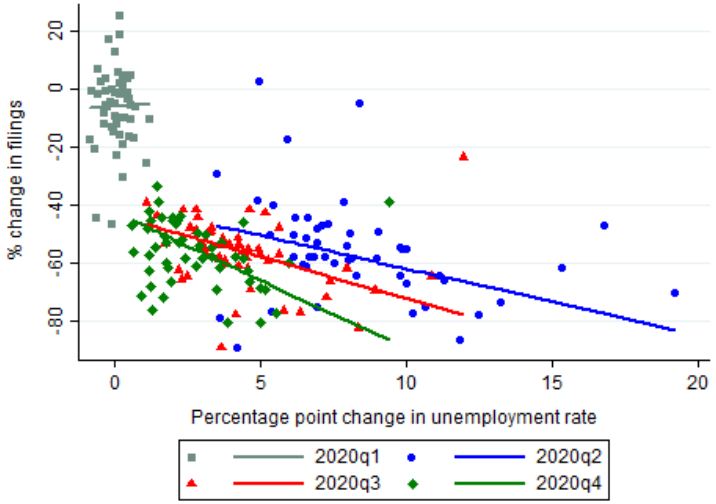
Y-axis:
YOY % change in bankruptcies

Consumer

Ch7

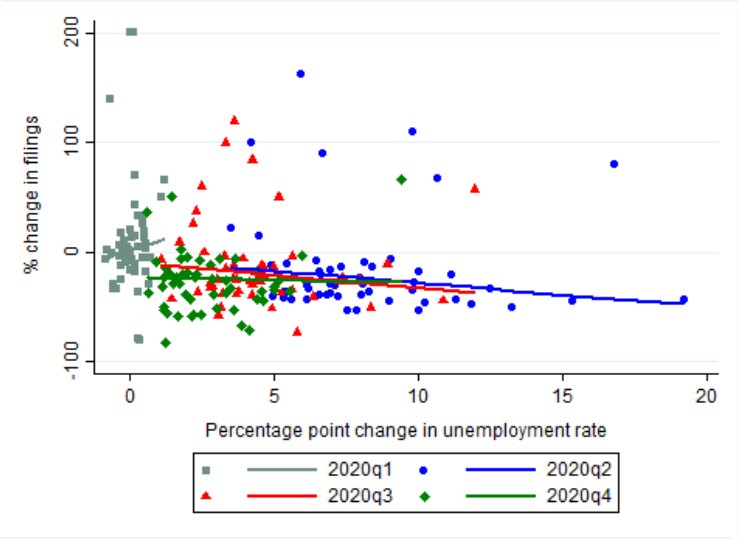


Ch13

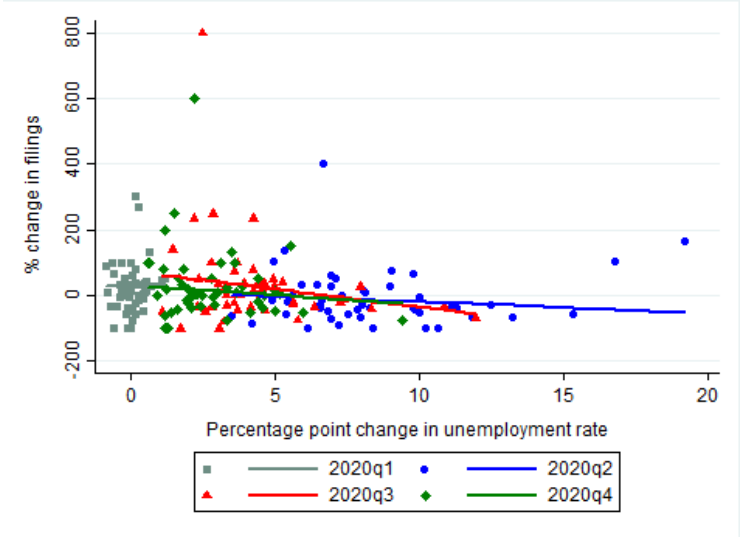


Business

Ch7



Ch11

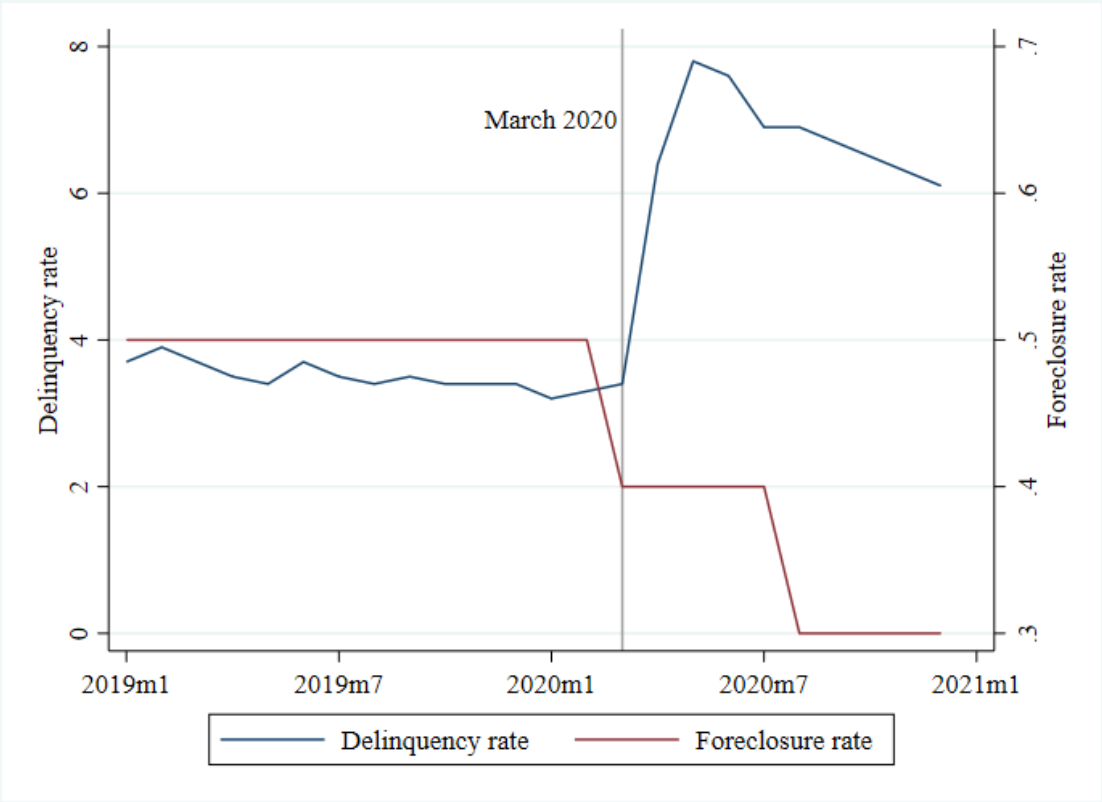


Why are bankruptcies down?

- In 2020: “missing” 232,000 household bankruptcies compared to 2019.
  - Probably “missing” a lot more than that because 2020 was much harder year economically
- Why?
  - **Lender forbearance**
  - Gov’t support (stimulus checks and PPP loans?)
  - Uncertainty

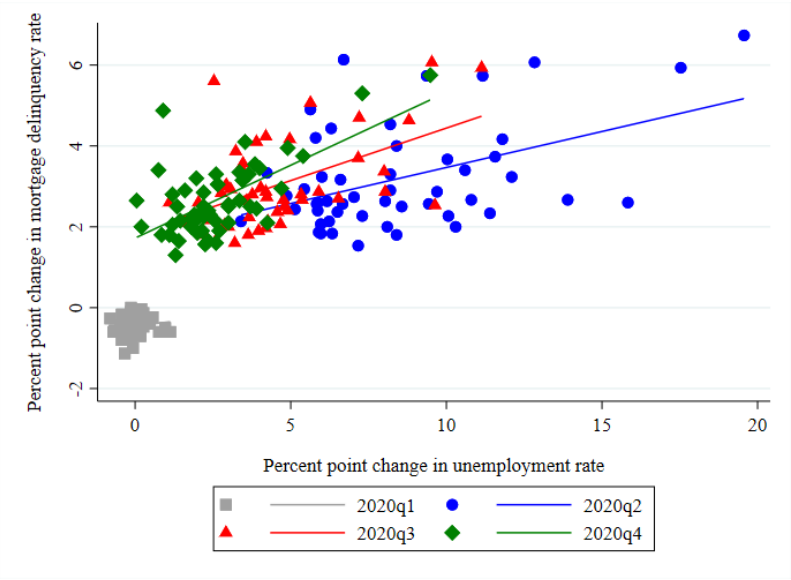
Creditor Leniency

Mortgage delinquency ↑, foreclosure ↓

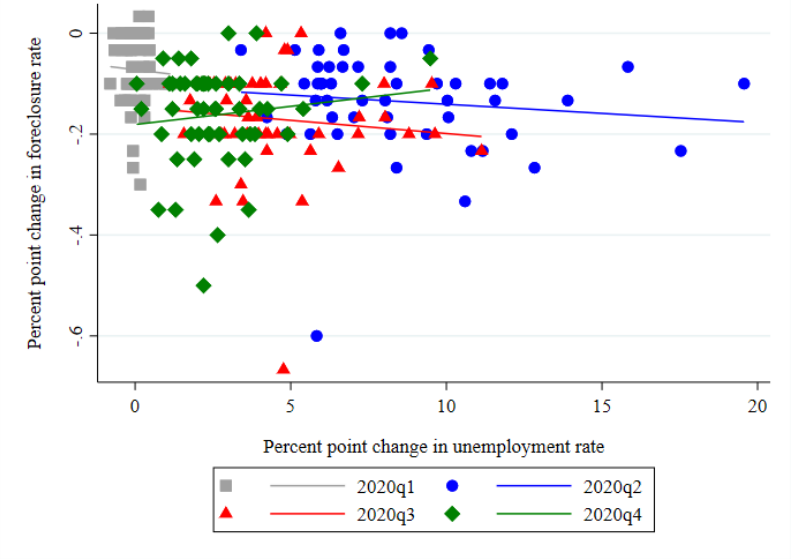


Source: Black Knight/McDash

Delinquency ↑ in high unemployment states



Foreclosure ↓ in high unemployment states



Major Takeaways

- There is likely a lot of financial distress that still needs to be dealt with
  - At least 230,000 households that would have filed for bankruptcy absent a pandemic
  - And the economy is probably at least somewhat different going forward, so some extra restructuring is likely needed
- Bankruptcy is one way to do this, but not the only way

- Big question: what happens when moratoria and leniency end???

Using Tax Incentives to Encourage Restructuring

Greenwood & Thesmar Proposal

- Government subsidizing renegotiation with tax incentives
- Suppose you have renter who owes landlord $10,000
- Voluntary agreement signed by both landlord and renter
  - Landlord gives up claim to unpaid rent: $10,000 of debt relief
  - Renter does not have to move
  - Landlord receives a tax credit for a fraction of the forgiven rent (say, $2,000)
- Shares costs of restructuring between taxpayers and landlords
- Avoids: extra bankruptcies, unnecessary evictions, etc.

Conclusion

- Bankruptcies fell dramatically in 2020, counter to historical trends
- Evidence on channels:
  1. Creditor Leniency: Ch. 13 filings down, homeowner filings down
  2. Liquidity constraints: pro se filings down, rebound in filings corresponds to stimulus
  3. Uncertainty: likely important
  4. Physical constraints: not likely a large factor

- Most debtors won't file until forced to do so by creditors
  - Large firms are exception: view bankruptcy as strategic option