Medical Xpress

Why medical debt – and bankruptcy – are growing problems

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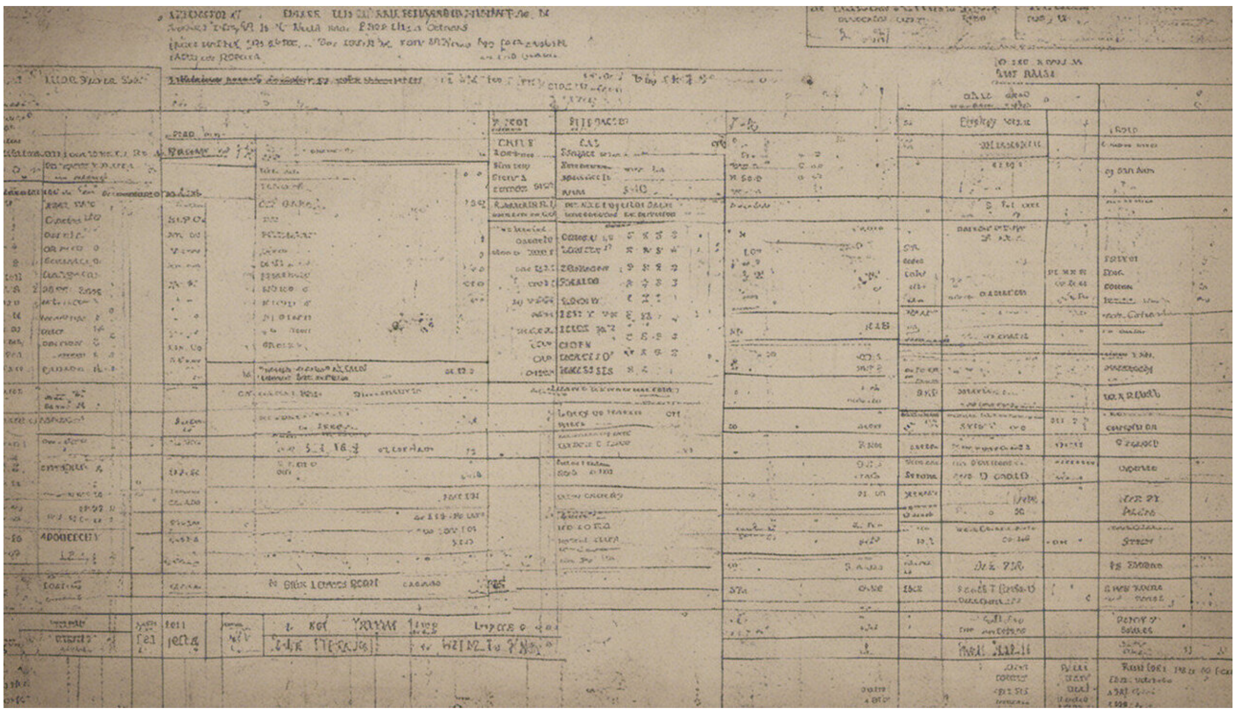

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Burdensomely high medical costs are often blamed for pushing many Americans into bankruptcy. According to the Consumer Financial Protection Bureau some 43 million Americans have unpaid medical debt on their credit reports.

Medical debt isn't like other debt. It is not because of unwise purchases, but often because of unforeseen circumstances, like an illness or accident. Unpaid medical debts can harm credit scores, which can make it harder to apply for loans, apply for credit cards or apply for a lease.

My own research on medical debt shows that medical expenses are the predominant factor in 18% to 26% of consumer bankruptcy filings – the leading causal factor.

What is bankruptcy?

Declaring bankruptcy allows the filer to discharge most types of unsecured debts, such as credit cards, civil judgments or personal loans. Unsecured debts are not backed by an asset. Secured debts, on the the hand, are backed by an asset and include things like home mortgages and most auto loans. They are not discharged in bankruptcy if the debtor intends to keep the property.

Depending on their income, debtors can file for "liquidation" of debts under Chapter 7, or repayment of part of their debts over time under Chapter 13.

The bankruptcy will stay as a negative reference on their credit report for up to ten years, and it can disqualify a person from jobs and make it harder to rent property. Bankruptcy filers will pay substantially higher interest rates for credit for years.

How can we tell that medical debt is a factor in bankruptcy?

To find out what role medical debt plays in causing consumer bankruptcy, I generated two sets of data. First, I analyzed bankruptcy schedules filed by debtors in 500 randomly selected bankruptcy cases during 2013. Bankruptcy schedules are the standardized forms on which debtors report income, expenses, assets, liabilities and other financial data. Then I looked at results from a nationwide survey of debtors.

Bankruptcy schedules disclose medical debt owed to physicians, hospitals, labs, pharmacies, medical credit providers and other medical-related expenses. Additionally, prior studies have shown that approximately 23% of credit card charges are for medical bills. So, for each debtor I added the total reported medical expenses plus 23% of the outstanding credit card balance to determine the total amount of medical debt.

The data revealed that 61% of all debtors carry medical debt and that the average medical debt per debtor in 2013 was US$9,374. Debtors in my sample also reported an average of $55,967 in unsecured debt and annual income of $40,920. Of these, a total of 18% of debtors had medical debt that was greater than half of their total unsecured debt or half of their annual income.

One of the key reasons that people file for bankruptcy is to discharge unsecured debt. If medical bills make up more than half of a person's unsecured debt or is greater than half of their income, then medical debt is probably a major factor in causing the person to file bankruptcy.

Around 18% of debtors in my sample had medical debt greater than half of their total unsecured debt or annual income, so we can conclude that medical debt was the predominant factor in 18% of the bankruptcies in my sample.

Why do people decide to file for bankruptcy?

Along with my analysis of debtor schedules, I conducted a nationwide survey of people who filed for bankruptcy in 2013.

The survey asked debtors what caused them to file bankruptcy and then listed standard reasons such as loss of income, illness and others (including "reason not listed here"). Out of 446 responses, medical debt was given as the single biggest cause of bankruptcy, with 21% of respondents answering "strongly agree," and a combined 26% of respondents answering "strongly agree" or "somewhat strongly agree" that they filed because of medical bills. Incidentally, job loss was given as the second highest single cause, with 19% of debtors answering "strongly agree," and 20% answering either "strongly agree" or "somewhat strongly agree."

So consumer debtors themselves attribute their bankruptcies to medical debt at rates relatively similar to those I determined by analyzing financial data on bankruptcy schedules. Using two types of data, we have a credible picture that medical debt is the predominant factor in 18% to 26% of consumer bankruptcies.

Why is understanding medical debt important?

In contrast to many other types of consumer debt, debtors usually don't choose to incur medical expenses and they have even less control over the amount.

And there is no standard system for when medical providers turn unpaid bills over to a third party for collection or report the debt to credit reporting agencies. Some may wait only 30 days before sending unpaid bills to a third party collector – others may wait up to 180 days, according to the Consumer Financial Protection Bureau. Recently the Obama administration enacted new rules to protect low-income patients from aggressive debt collection practices from nonprofit hospitals, including reporting unpaid debt to collection agencies and credit reporting bureaus, suing patients and garnishing their wages.

Moreover, whether or not a person has medical insurance is unrelated to whether the person needs medical care. For this reason, the Fair Isaac Corp (FICO), which calculates credit scores, now weighs medical debt differently when calculating credit scores. They recognize that medical spending is seldom discretionary.

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