

Mandatory Financial Education As Prerequisite to Personal Insolvency Relief: The North American Experience

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I. Introduction

Mandatory financial education as a prerequisite to relief from overindebtedness is a seemingly sound idea in a vain search for compelling theoretical and empirical support. The North American experience, especially in the United States over the past 10 years, provides neither. Moreover, available theory and evidence strongly suggest that no such support is likely forthcoming, and it is unjustified to mandate such training for those seeking relief from severe financial distress. Even if there were a compelling case to be made for mandatory financial education as part of a personal insolvency relief system, such regimes as currently constructed are of decidedly little value. Lawmakers are better advised to either scrap these mandates or vastly expand the scope and extent of the training programs. The latter option will impose significant expense and inconvenience on debtors, insolvency relief systems, and perhaps taxpayers. The ultimate question here is whether the significant costs of mandating financial education are justified by the limited and likely illusory benefits.

II. North American Regimes

A. Canada

Canada has offered bankruptcy relief to overindebted individuals since the early 1900s, but in 1992, it became the first country to require that debtors receive financial management counselling as a prerequisite to obtaining a discharge.¹ This measure was adopted in response to the troubling incidence of repeat bankruptcy filings (10-12% of all personal bankruptcies in the 1980s), and mandatory financial management education and counseling were designed to reduce this trend.²

Private case administrators (trustees, most of whom are accountants) were charged with providing this education and counselling or contracting this task out

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¹ Bankruptcy and Insolvency Act § 157.1 [Canada]. See Ruth E. Berry & Sue L.T. McGregor, "Counselling Consumer Debtors Under Canada's *Bankruptcy and Insolvency Act*," 37 *Osgoode Hall L.J.* 369, 371 (1999).

² See Berry & McGregor, *id.*; Industry Canada, *Evaluation of Mandatory Counselling: Final Report* 1-2 (2013).

to counselling providers. Trustees and other counselling providers must be specially qualified to deliver counseling by taking a special Insolvency Counsellor's Qualification Course administered through the Canadian Association of Insolvency and Restructuring Professionals. The course covers four "modules" (i) personal insolvency law, (ii) interviewing and counselling, (iii) elements of money management, and (iv) "money in context," and it concludes with an examination. Candidates are advised to "expect to spend at least 50 to 100 hours on the course as well as 15 to 30 hours observing a qualified counsellor in the role of counselling debtors."³

A government regulator, the Office of the Superintendent of Bankruptcy, issues administrative directives guiding the implementation of this counselling mandate. The directive defines the notion of "counselling" as follows:

to assist and educate . . . consumer debtors on good financial management, including prudent use of consumer credit and budgeting principles; in developing successful strategies for achieving financial goals and overcoming financial setbacks; and, at any time, where appropriate, in making referrals to deal with non-budgetary causes of insolvency (i.e. gambling, addiction, marital and family problems, etc.).⁴

These goals are to be pursued in two stages. In the first counselling stage, called "consumer and credit education," at some point during the first two months of the case, the trustee is to provide information and "consumer advice" in four discrete areas: (i) money management; (ii) spending and shopping habits; (iii) warning signs of financial difficulties; and (iv) obtaining and using credit.⁵ In the second stage, called "Identification of Roadblocks to Solvency and Rehabilitation," at least a month after the first session but no later than seven months after case initiation, the trustee endeavors to prepare the debtor for life after bankruptcy by determining "the budgetary and/or non-budgetary causes of insolvency," and assisting the debtor "to better understand his or her strengths and weaknesses with regard to money management and budgeting skills."⁶ In addition, "where appropriate," the trustee is charged with assisting the debtor with identifying "the non-budgetary causes (such as gambling abuse, compulsive behaviour, substance abuse, employment and

³ CAIRP, Insolvency Counsellor's Qualification Course, <http://www.cairp.ca/insolvency-professionals/additional-industry-courses/insolvency-counsellor-s-qualification-course/>.

⁴ Office of the Superintendent of Bankruptcy, *Directive No. IR3, Counselling in Insolvency Matters*, § 2 (in force since Sept. 2009).

⁵ *Id.* §§ 5-6.

⁶ *Id.* §§ 5, 7(1)(a).

marital or family difficulties) that may have contributed to his or her financial difficulties” and educating the debtor on “his or her behaviour in financial management and consumption habits” and available resources that might help the debtor to “achieve and maintain economic stability.”⁷ Finally, the trustee is expected to “develop recommendations and alternatives for a financial plan of action that, if appropriate, may include referral for specialized counselling to deal with non-budgetary causes of insolvency.”⁸

No specific content or even time period is prescribed for these two counselling sessions, though one empirical survey found that the norm tended to be 30-45 minutes per session.⁹ For each of these stages, the trustee is entitled to withdraw from the estate a prescribed fee of \$85. Debtors and their creditors thus effectively pay for these education and counseling sessions. An official evaluation observes that this mandatory counselling is thus “a significant activity for the insolvency system,” leading to a disbursement of nearly \$18 million in prescribed fees in 2011-12.¹⁰

B. United States

The famously generous US consumer bankruptcy law was substantially revised in 2005 with the adoption of the so-called Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). Drafted and aggressively lobbied by the consumer credit industry, BAPCPA was explicitly designed to reduce the skyrocketing numbers of consumer bankruptcy filings. One tactic in this effort was to impose two counselling requirements on all individuals seeking relief: pre-bankruptcy “credit counselling” and a pre-discharge “instructional course concerning personal financial management.”¹¹ The apparent purpose of the pre-bankruptcy counselling is to gauge whether a non-bankruptcy alternative might be available to solve the debtor’s financial problems, so this session involves little or no education and will not be discussed further here. The second session is the educational one, and like in Canada, completing this course is a prerequisite for obtaining a discharge.¹²

⁷ *Id.* § 7(1)(b).

⁸ *Id.* § 7(1)(c).

⁹ Iain Ramsay, “Market Imperatives, Professional Discretion and the Role of Intermediaries in Consumer Bankruptcy: A Comparative Study of the Canadian Trustee in Bankruptcy,” 74 *Am. Bankr. L.J.* 399, 443 (2000).

¹⁰ See Industry Canada, *supra* note 2, at 4.

¹¹ 11 USC § 111.

¹² 11 USC §§ 727(a)(11), 1328(g).

Unlike the Canadian reform law, BAPCPA offered no guidance on the content or structure of the instructional course other than a vague mandate “to assist debtors in understanding personal financial management.”¹³ It relegated responsibility for approving course providers, and therefore regulating course content, to the relevant government supervisory agency, the US Trustee or Bankruptcy Administrator.¹⁴ In 2006, the Executive Office for US Trustees published interim regulations for approval of financial management course providers, followed by a substantively similar final regulation in 2013.¹⁵

Also unlike in Canada, counselling and education in the US are seldom provided by trustees (most of whom in the US system are lawyers), though the regulations require providers to have one of several certified credentials (Certified Financial Planner, credit counsellor, Registered Financial Consultant, or Certified Public Accountant), have taken at least a six-month course or worked for six months in a personal finance-related area, and have two years’ experience offering such courses.¹⁶

On the substance of such courses, the regulation offers a bit more detail than the Canadian equivalent, but it calls for generally similar coverage while leaving considerable leeway for variations in approach and treatment. The current final regulation explicitly mandates that learning materials must cover the following topics and subtopics:

- (1) budget development, including (i) setting short-term and long-term financial goals, as well as developing skills to assist in achieving these goals; (ii) calculating gross monthly income and net monthly income; and (iii) identifying and classifying monthly expenses as fixed, variable, or periodic;
- (2) money management, including (i) keeping adequate financial records; (ii) developing decision-making skills required to distinguish between wants and needs, and to comparison shop for goods and services; (iii) maintaining appropriate levels of insurance coverage, taking into

¹³ 11 USC § 111(d)(1)(B).

¹⁴ The US Trustee is a branch of the US Department of Justice and the government supervisor for the bankruptcy system, with both individual case oversight responsibilities and regulatory authority, in all but two states, Alabama and North Carolina, where a previous system of so-called Bankruptcy Administrators fills this role. See <https://www.justice.gov/ust/about-program> and <http://www.uscourts.gov/services-forms/bankruptcy/trustees-and-administrators>.

¹⁵ 28 C.F.R. §§ 58.25-58.36.

¹⁶ 28 C.F.R. § 58.33(d).

account the types and costs of insurance; and (iv) saving for emergencies, for periodic payments, and for financial goals;

- (3) wise use of credit, including (i) identifying the types, sources, and costs of credit and loans; (ii) identifying debt warning signs; (iii) discussing appropriate use of credit and alternatives to credit use; and (iv) checking a credit rating;
- (4) consumer information, including (i) identifying public and nonprofit resources for consumer assistance; and (ii) identifying applicable consumer protection laws and regulations, such as those governing correction of a credit record and protection against consumer fraud; and
- (5) coping with unexpected financial crisis, including (i) identifying alternatives to additional borrowing in times of unanticipated events; and (ii) seeking advice from public and private service agencies for assistance.¹⁷

Providers must offer at least two hours' instruction encompassing all of these topics, for which they are entitled to collect from debtors no more than a maximum fee of \$50 and must waive the fee for debtors with income below 150% of the official poverty line.¹⁸

An early evaluation of the first approved financial management courses in one large-population East Coast state revealed that most relied on some degree of internet access, with half of the courses delivered via internet only, and another 34% delivering instruction via internet or telephone (and consumers who chose the telephone option were charged \$20 more).¹⁹ National statistics on delivery methods reflected similar trends, though internet delivery has come to dominate in recent years. The content of these early courses was not targeted at bankruptcy filers, however. General financial management curricula were simply made available to satisfy the bankruptcy mandate. Consequently, topics such as investing in mutual funds and stocks were consistently presented, while important bankruptcy-specific topics were omitted, such as problems with credit reporting of discharged debts,

¹⁷ 28 C.F.R. § 58.33(f).

¹⁸ 28 C.F.R. § 58.33(g), 58.34 (allowing a fee greater than \$50 only upon special application to and approval by the US Trustee, and allowing providers to rebut the presumption of a fee waiver for low-income debtors).

¹⁹ Deanne Loonin, John Rao & Mallory SoRelle, National Consumer Law Center, *New Burdens But Few Benefits: An Evaluation of the Bankruptcy Counseling and Education Requirements in Massachusetts* 11 tbl. 1 (2007).

common targeting of recent bankruptcy debtors with predatory offers of high-rate credit, and the enforcement of the discharge and exceptions to it.²⁰

III. Developing Baseline Expectations: Failure All But Assured

Before evaluating recent experience with these financial management courses, it is worthwhile to develop expectations. In other words, should we expect these courses to achieve their goals of reducing repeat bankruptcy filings and reducing the number of bankruptcies generally by arming consumers with better information on financial management? Based only on the description of the course designs laid out above, one might anticipate significant if not total failure. This entire initiative is based on the faulty premises that financial illiteracy is among the key causes of financial distress and personal bankruptcy, and that brief remedial training in navigating the maze of modern consumer finance would reduce the incidence of insolvency to a significant degree. Arming debtors with basic financial information can hardly be expected to offer effective defenses against the harsh realities of income disparity, risk, and the complexity, biases, and manipulation inherent in modern consumer finance.

A. The False Premise

The most significant problem with the notion of imposing financial education on debtors as a condition of discharge is the false premise motivating this initiative. No reliable empirical evidence exists to indicate that a major source of financial distress is financial illiteracy or incompetent money management. While credit counseling and reporting organizations sometimes claim that poor money management and/or excessive spending are common causes of individual financial distress, these conclusions are rife with problems, including a basic failure to carefully define terms like “poor money management” and “excessive spending.”²¹

Both counselors and debtors are likely confusing symptoms with the underlying disease, mistaking effects for causes. Is insolvency caused by excessive borrowing, or it is caused by the illness or unemployment and consequent shortage of income that forced the debtor to borrow “excessively”? Is insolvency caused by imprudent debt spending on houses, cars, and household goods, or is it caused by the unexpected divorce or factory closing that sharply interrupted the debtor’s expected income, which would otherwise have been sufficient to service the debt? Is financial distress caused by poor savings habits that leave consumers vulnerable to

²⁰ *Id.* at 35-36.

²¹ For a discussion of problems with such conclusions, see *id.* at 39-40.

short-term income interruptions, or is it caused by market forces depressing income, leaving barely enough to cover basic needs with no excess to put aside for a rainy day? Separating causes from effects and tracing the series of actions and reactions back to its origin seldom reveals financial mismanagement or poor spending habits as the first link in the chain of financial distress.

Instead, study after study indicates that accidents of life and the inevitable risks associated with modern consumer finance are the overwhelmingly most common root causes of personal insolvency.²² Even solid plans made by financially savvy individuals are often upended by job loss (especially long-term, structural unemployment), family disruption, illness, and other economic factors usually entirely outside of consumers' control. These causes have been recognized time and again as the real foundations of personal insolvency, not financial illiteracy or incompetence. Thus, there is a fundamental mismatch between the theory motivating mandatory financial management instruction and the reality of the micro- and macro-economic causes of the overwhelming majority of personal insolvencies.

It is empirically and morally unjustified to lay blame for the inevitable casualties of modern economic volatility at the feet of consumers and their supposed financial illiteracy. Modern society encourages consumers to spend and to borrow to smooth consumption patterns to enhance economic productivity.²³ It encourages consumers to “plan for the future” and take risks by borrowing for both consumption and business. If modern society wants to enjoy the rewards of robust economic activity, it must embrace the accompanying risks. It cannot very well lay the blame for those risks at the feet of consumers who accept constant invitations from both government and industry to participate actively in the open credit economy. One commentator aptly criticized the study that led to the adoption of the financial management counselling requirement in Canada: “This opinion [that bankruptcy results from compulsive behavior] was based on the premise that personal bankruptcy is entirely a personal phenomenon The role of the economy, the

²² See, e.g., Elizabeth Warren & Amelia Warren Tyagi, *The Two-Income Trap: Why Middle Class Mothers and Fathers are (Still) Going Broke* (2016); Béatrice Raoult-Texier, Banque de France, *Étude des Parcours Menant au Surendettement* 7 (2014); Robert M. Lawless et al., “Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors,” 82 *Am. Bankr. L.J.* 349 (2008); Elizabeth Warren, “Financial Collapse and Class Status: Who Goes Bankrupt?,” 41 *Osgoode Hall L.J.* 115 (2003); Saul Schwartz, “The Empirical Dimensions of Consumer Bankruptcy: Results from a Survey of Canadian Bankrupts,” 37 *Osgoode Hall L.J.* 83 (1999); Teresa A. Sullivan, Elizabeth Warren & Jay L. Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (1989).

²³ See, e.g., Robert J. Shiller, “Spend, Spend, Spend. It’s the American Way,” *New York Times*, Jan. 15, 2012, at BU3.

government, the creditors ... or any other factor external to the bankrupt person were not considered.”²⁴ Proponents of financial management education bear the burden of producing credible empirical evidence that such an intervention is likely to have any connection to the root causes of personal insolvency. So far, they have failed to do so, relying instead on empty rhetoric and conjecture.²⁵

B. Financial Education: Inherently Ill-Equipped to Task

Indeed, not only is poor financial management not a common root cause of personal insolvency, excellent financial management is generally powerless to avert the macroeconomic volatility and risks inherent in modern consumer finance. Even structured properly, financial education should not be expected to arm consumers against increasing complexity, biases, and manipulation in the changing nature of modern consumer financial products. If an education deficiency lies at the root of consumer financial mismanagement, it is much more likely basic mathematical weakness and innumeracy, not lack of specific knowledge of finance. Even educated consumers struggle with basic mathematical concepts like percentages, compound interest, and annual percentage rates, despite decades of government efforts to make these key concepts easier to understand and use in comparison shopping.²⁶

The consumer credit industry has grown exponentially over the past few decades thanks in large part to deployment of sophisticated information technology and the intentional leveraging of known cognitive biases and weaknesses among all consumers. Institutional creditors regulate their risks by using modern data collection and processing capabilities to gauge consumers’ future profitability, and by manipulating offers of credit based on expectations of likely late payment or even default.²⁷ Even for well-informed consumers, “the complexity and proliferation of new products impairs the ability of individuals to identify which products are appropriate for them,” in part because “best practices” taught in an earlier era are often rendered useless or even harmful by new credit products.²⁸ Arguably the most

²⁴ Carol Ann Curnock, “Insolvency Counselling—Innovation Based on the Fourteenth Century,” 37 *Osgoode Hall L.J.* 387, 392 (1999).

²⁵ See, e.g., Jean Braucher, “Debtor Education in Bankruptcy: The Perspective of Interest Analysis,” in *Consumer Bankruptcy in Global Perspective* 319 (Johanna Niemi-Kiesiläinen et al., eds., 2003); Lauren E. Willis, “Evidence and Ideology in Assessing the Effectiveness of Financial Literacy Education,” 46 *San Diego L. Rev.* 415 (2009).

²⁶ Jinhook Lee & Jeanne M. Hogarth, “The Price of Money: Consumers’ Understanding of APRs and Contract Interest Rates,” 18 *J. Pub. Pol’y & Marketing* 66 (1999) (reporting on an empirical study in which at least 40% of mortgage borrowers failed to understand the relationship between the contract interest rate and APR).

²⁷ See, e.g., Lauren E. Willis, “Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price,” 65 *Maryland L. Rev.* 707 (2006).

²⁸ Lauren E. Willis, “Against Financial-Literacy Education,” 94 *Iowa L. Rev.* 197, 213, 215-16 (2008).

financially savvy US consumer, Treasury Secretary Henry Paulson, defended the failure of government regulation to avert the subprime housing crisis and resulting (worldwide) financial crisis by noting “[h]istory says it’s very difficult for policy to keep up with innovation.”²⁹ If financial policymakers at the highest levels cannot be expected to “keep up with innovation” in the consumer financial sector, how are ordinary people supposed to do so?

Not only does the consumer finance industry use technology against its customers, it uses customers’ own widely misunderstood psychology against them. Borrowing decisions necessarily require predictions of future events (e.g., salary increases, stable job prospects, financial crisis), and psychologists have revealed that individuals are extremely poor at making accurate probabilistic forecasts.³⁰ Scientists have uncovered cognitive biases and mental shortcuts (“heuristics”) that consistently skew our appreciation of future probability and therefore our evaluation of products involving risk.³¹ The credit industry has increasingly taken advantage of these psychological biases and weaknesses in convincing consumers to obtain expensive, high-risk credit.³² We all suffer from these biases, we all apply these heuristics to a greater or lesser degree to overcome our inherent human cognitive limitations, and it is next to impossible to counteract these deeply ingrained effects.³³

Financial education, no matter how well structured, is simply not up to the task of ensuring that debtors make wise borrowing decisions. In the early 2000s, the US Defense Department discovered that financial distress from high-cost predatory lending to its soldiers was undermining troop morale and military readiness, so it set out to remedy the financial management weaknesses of its new soldiers through education. It established a policy of financial management education for all new service members, with an “overall message ... to manage your finances, spend less than you earn, save money for when you need it, use credit wisely so that payments do not become overwhelming and be cautious in the

²⁹ *Id.* at 218 (citing James Kanter, “Paulson Cautions Against Rush to Regulation in Credit Crisis,” *New York Times*, Sept. 18, 2007, at C3).

³⁰ See, e.g., Daniel Kahneman & Amos Tversky, “Prospect Theory: An Analysis of Decision Under Risk,” in *Choices, Values, and Frames* 17 (Daniel Kahneman & Amos Tversky, eds., 2000).

³¹ For a description of the effect of many of these biases in the consumer finance sector, see Jason J. Kilborn, “Behavioral Economics, Overindebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions,” 22 *Emory Bankr. Dev. J.* 13, 16-22 (2005).

³² See, e.g., Oren Bar-Gill, “Seduction by Plastic,” 98 *NW.U. L. Rev.* 1373 (2004); Jon D. Hanson & Douglas A. Kysar, “Taking Behavioralism Seriously: The Problem of Market Manipulation,” 74 *N.Y.U. L. Rev.* 630 (1999); Christine Jolls et al., “A Behavioral Approach to Law and Economics,” 50 *Stan. L. Rev.* 1471 (1998).

³³ Willis, *supra* note 28, at 248-53.

marketplace.”³⁴ The DoD also established a marketing campaign called “Military Saves,” with a goal “to persuade, motivate and encourage Service members and their families to save money and reduce consumer debt.”³⁵ Despite these efforts, the DoD concluded that “a significant number of Service members, especially in the lower ranks of enlisted personnel, still fall victim to easy credit widely available around bases or online. Education does not trump the marketing of these loans and the easy availability of quick cash with few questions asked.”³⁶ If the military, with its enhanced degree of control and discipline over its members, cannot use well-structured and rigorously applied financial education to overcome the lure and consequences of predatory credit, one should hardly expect general, civilian financial education of bankrupt debtors to achieve superior results.

IV. Empirical Observations

These expectations of weakness are borne out in empirical studies, especially on the US side of the border. Unbiased observers recognize that financial management training has little value for the great majority of debtors, whose distress had little or nothing to do with their financial ineptitude. Debtors with greater general education also recognize this. If basic innumeracy is not remedied, even less-educated debtors who might benefit from financial management instruction will not reap its benefits. Mandatory financial management instruction thus represents just one more barrier separating needy debtors from the relief the system offers, with little if any purpose for imposing the expense and delay.

A. Canadian Evaluations and Studies

Though debtors and counsellors consistently rate mandatory counseling highly, disinterested bankruptcy professionals most involved in the process in Canada have long expressed deep misgivings about the value and effectiveness of the financial counseling mandate. In 1994, the first survey evaluation revealed that nearly two-thirds of trustees thought that counseling made little or no difference for debtors’ understanding or improvement of financial management.³⁷ In contrast, debtors’ perception of the counseling was more sanguine, with nearly 70% expressing confidence that it would help them to control their finances in the future. Those in semi-skilled or unskilled occupations were more likely to assess the

³⁴ U.S. Dept. of Defense, *Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* 23 (2006).

³⁵ *Id.* at 26.

³⁶ *Id.* at 45.

³⁷ Iain Ramsay, “Mandatory Bankruptcy Counseling: The Canadian Experience,” 7 *Fordham J. Corp. & Fin. L.* 525, 536 (2002).

counseling positively.³⁸ The following year, the Office of the Superintendent of Bankruptcy commissioned a stakeholder poll on the effectiveness of the new financial counselling mandate. While over 60% of credit counsellors thought the counselling was beneficial, only 20% of creditors shared this view.³⁹

A government evaluation in 2001 and an academic survey study in 2002 reflected a similar divergence of opinion between debtors and counselors, on the one hand, and trustees on the other. In the government evaluation, while debtors remained enthusiastic about the counseling, and 55% of counselors rated it very useful, only 30% of trustees characterized counseling as very useful.⁴⁰ The academic survey also revealed “general skepticism among trustees as to the value of counseling.”⁴¹ Trustees cited the mismatch between the supposed reasons for the counseling and the causes of consumer bankruptcies, as discussed above,⁴² and they doubted their own abilities to assess and remediate the deeper causes of personal insolvency, as mandated by the Canadian directive. At the same time, a key bankruptcy reform organization of trustees and lawyers, the Insolvency Institute, questioned the wisdom of mandating financial counseling for all debtors, noting “the experience of many trustees that counseling is simply not necessary for many individuals, and further, many individual will not benefit from counseling in any event.”⁴³ It is not surprising that counselors, whose vocation and livelihood were dependent on offering counseling, rated it highly;⁴⁴ it is disturbing that disinterested trustees and lawyers consistently rated it as little more than a waste of time and money.

Nonetheless, the mandate persists, and the most recent 2013 survey evaluation by Industry Canada reports a consistent split of opinion along the same lines as earlier studies. Remarkably, the evaluation begins by asking whether mandatory counselling addresses a continuing need, and it reveals that the number of repeat bankruptcies continued to gradually rise from 18% in 2007 to 20% 2012.⁴⁵ That is, the original goal of the mandatory counseling—to reduce the incidence of repeat filing—has clearly not been met, even after 20 years of the mandate. This

³⁸ *Id.* at 537.

³⁹ Berry & McGregor, *supra* note 1, at 382.

⁴⁰ Ramsay, *supra* note 37, at 538.

⁴¹ *Id.* at 533.

⁴² See *supra* Part III.A.

⁴³ Ramsay, *supra* note 37, at 534 (citing *Report of the Personal Insolvency Committee of the Insolvency Institute of Canada, Recommendations for Reform and Further Amendments to the Bankruptcy and Insolvency Act Personal Insolvency Provisions* 12 (2001)).

⁴⁴ See Willis, *supra* note 28, at 205; Ramsay, *supra* note 37, at 538.

⁴⁵ Industry Canada, *supra* note 2, at 10.

very first statistic seems to belie the following claim that mandatory counseling “directly addresses the rehabilitation needs of these bankrupts” and “can help debtors who have mismanaged their finances.”⁴⁶ Debtors once again overwhelmingly (more than 90%) praised the counseling they received as useful in avoiding future financial distress, though it is particularly telling that 89% of *repeat* bankruptcy filers expressed this sentiment.⁴⁷ If it did not help them the first time, is there reason to believe that it will be more effective the second or third?

Trustees and counsellors reported that counseling was not relevant for debtors who filed as a result of business failure or “victims of circumstance.” Industry Canada characterized these debtors as “small in number,” though immediately admitted that filings by “[v]ictims of circumstance are not tracked.”⁴⁸ The overwhelming weight of empirical evidence, discussed above,⁴⁹ would suggest that victims of circumstance, reasonably defined, are anything but “small in number” in the bankruptcy system.

The latest evaluation also casts doubt on the effectiveness of the counseling in actually educating debtors. While results on post-counseling questionnaires showed basic knowledge of prudent budgeting practices, “there were gaps in debtor knowledge regarding the terms and conditions for credit cards,” with only 28% of debtors answering the relevant question correctly.⁵⁰ If one of the primary culprits for consumer financial distress remains a mystery for debtors, how can this mandatory financial counseling be characterized as “effective” in any meaningful sense? It is hard to take seriously an evaluation concluding that mandatory financial counseling is effectively serving its purpose when that same study reports that repeat filings continue their relentless march upwards, repeat filers believe the counseling (which they already have received once) will be helpful in avoiding future bankruptcy, and debtors fail to understand the basics of credit card terms immediately after the counseling.

B. US Evaluations and Studies

Assessments of mandatory pre-discharge financial management courses in the US show strikingly similar results to those in Canada, with robust support among debtors and counselors and skepticism among lawyers and trustees. A recent and more careful qualitative survey of debtors, however, for the first time

⁴⁶ *Id.* at 11.

⁴⁷ *Id.* at 12, 15-16.

⁴⁸ *Id.* at 12-13.

⁴⁹ See *supra* note 22 and accompanying text.

⁵⁰ Industry Canada, *supra* note 2, at 17.

reflects a significant degree of dissatisfaction even among this historically positive group.

In 2008, the Executive Office for US Trustees (EOUST) contracted with a survey company to evaluate a curriculum it had commissioned for mandatory financial education courses. As in earlier surveys in Canada, this first major US evaluation found that debtors were overwhelmingly enthusiastic about the course (97%), though post-course surveys showed that debtor knowledge had increased only marginally.⁵¹ Presumably unaware of the mismatch problem discussed above,⁵² the contracted surveyor made the prescient suggestion that perhaps “debtors were already knowledgeable about financial practices but may have experienced financial problems due to an unanticipated crisis (e.g., illness, job loss, or divorce) instead of poor financial management.”⁵³

This theory was prompted by debtors’ explanations for their reasons for filing, which are consistent with empirical data discussed above,⁵⁴ with 83% reporting that an “unexpected/unavoidable change in financial situation” was at least part of the reason for their bankruptcy (and 53% cited this as the sole reason).⁵⁵ The surveyor candidly divulged that the curriculum was designed “on the assumption that many if not most debtors seriously overspent because they were unaware of sound financial management practices,” but after examining the survey data, the surveyor concluded “[l]ack of knowledge may not have been the problem for many or most of these debtors.”⁵⁶

Also in 2008, a private industry study sought to measure the effect of mandatory pre-discharge counselling on debtors’ financial well-being. Commissioned by a major counseling provider, Money Management International (MMI), this study was designed to assess the impact of MMI’s “product.”⁵⁷ Like the EOUST survey of that same year, the MMI study found that virtually all debtors (98%) felt very confident in their knowledge gains from the instruction, but examination of the results of MMI’s financial management instruction course showed that debtors actually improved their knowledge only marginally, with

⁵¹ U.S. Dept. of Justice, Exec. Office for U.S. Trustees, *Report to Congress: Evaluation of Instructional Classes in Personal Financial Management for Consumer Bankruptcy Debtors* 5 (2008).

⁵² See *supra* Part III.A.

⁵³ U.S. Dept. of Justice, *supra* note 51, at 5.

⁵⁴ See *supra* note 22 and accompanying text.

⁵⁵ U.S. Dept. of Justice, *supra* note 51, Exh. 1, at 49 exh. 3-19.

⁵⁶ *Id.* Exh. 1, at 52.

⁵⁷ Angela C. Lyons et al., *The Effect of Bankruptcy Counselling and Education on Debtors’ Financial Well-Being: Evidence From the Front Lines* 5 (2008).

scores rising only 5%, from 80.3% to 85.5% between pre- and post-course testing.⁵⁸ This again may be due to the same “mismatch” factor observed in the EOUST study, as 54.3% of debtors listed job loss as a reason for their bankruptcy filing, with another 42.9% listing health problems and medical bills.⁵⁹ Acknowledging the argument that most debtors’ financial problems are largely due to events beyond their control rather than financial mismanagement, MMI to its credit also candidly admitted “[s]ince this study found that debtors already knew much of the course content beforehand, this argument may be somewhat valid.”⁶⁰

Academic studies of mandatory financial education reflect an increasingly somber attitude by many debtors toward the value of these courses. One early study asked debtors who had filed in 2001, and were thus not required to attend a financial management course, if such a course would have helped them to avoid bankruptcy. Over 54% expressed the feeling that such a course would have helped at least somewhat, though debtors with a college degree were more likely (60%) to report that such a course would not have helped at all.⁶¹ A follow-up study compared attitudes of the 2001 debtors with those who filed in 2007, and thus were subject to the financial instruction mandate. The debtors who were required to attend a course were much less enthusiastic about its value, with 66.7% reporting the course would not have helped them to avoid bankruptcy.⁶² Once again, less-educated debtors were more likely to perceive some value in the course, as were debtors who were not very familiar with their household finances (because someone else managed the household finances).⁶³ Proving once again that hope springs eternal, however, a large majority of debtors (72%) believed that the course would help them to avoid bankruptcy in the future, though again, only 60.5% of college-educated debtors shared this optimism.⁶⁴

The most recent survey of debtor attitudes toward financial management instruction involved a small number of debtors from one state, but its findings are both disheartening and revealing. An academic researcher interviewed a random sampling of 58 debtors from all those who had sought bankruptcy (Chapter 7) relief

⁵⁸ *Id.* at 21. It is common for individuals to overestimate their knowledge gains and consequent control from financial education. See Willis, *supra* note 28, at 205, 273.

⁵⁹ Lyons et al., *supra* note 57, at 21.

⁶⁰ *Id.* at 28.

⁶¹ Deborah Thorne & Katherine Porter, “Financial Education for Bankrupt Families: Attitudes and Needs,” 24 *J. Cons. Ed.* 15, 18, 20 tbl. 1 (2007).

⁶² Deborah Thorne & Katherine Porter, *Debtor’s Assessments of Bankruptcy Financial Education 7* (2010) (working paper at <http://ssrn.com/abstract=1654417>).

⁶³ *Id.* at 9, tbl. 1.

⁶⁴ *Id.*

in Colorado in 2006, 2008, and 2010.⁶⁵ The author describes the results of the survey bluntly: “The majority of the individuals did not find the courses to be helpful at all, and several had very strong negative opinions about the courses,” with a very common appraisal being that the courses were “a complete waste of time.”⁶⁶ Only four individuals, two joint-filing couples, found one of the courses helpful.⁶⁷ Careful examination of these debtor’s detailed interview comments offered another important revelation: If any change occurred in debtors’ future financial management practices, it was as a result of the traumatic experience of the bankruptcy process and a desire never to repeat it, not of any financial management instruction.⁶⁸ As more than one debtor evocatively put it, their greater spending control resulted from the “school of hard knocks” of going through the psychological stress and ignominy of a bankruptcy case, not from anything learned in the financial management course.⁶⁹

V. Conclusion

There is simply no credible theoretical or empirical support for the notion that financial education could even make a dent in the levels of personal financial distress we see today. The North American experience with mandatory pre-discharge financial management instruction bears this out. Given the documented causes of consumer insolvency, no one should expect that financial education could stave off the sorts of risks to which the modern global economy exposes individuals. The best made plans can be laid waste by an unforeseen event halfway around the world (e.g., ultra-risky subprime mortgage bond trading by New York investment bankers triggers a worldwide recession). No amount of financial management training could have prevented the great majority of individual bankruptcies since the beginning of the 2008 global financial crisis.

For a few debtors, a bit of introductory training in basic math and financial literacy may have some value, but only if it is tailored to their needs and voluntary. It is affirmatively harmful to mandate financial management courses as a prerequisite to obtaining a discharge.⁷⁰ The millions of dollars squeezed from struggling debtors and redistributed to financial instruction companies is virtually a dead-weight loss to the economy. Would not that money be much better spent by

⁶⁵ Michael D. Sousa, “Just Punch My Bankruptcy Ticket: A Qualitative Study of Mandatory Debtor Financial Education,” 97 *Marquette L. Rev.* 391, 431-33 (2013).

⁶⁶ *Id.* at 398, 442.

⁶⁷ *Id.*

⁶⁸ *Id.* at 457.

⁶⁹ *Id.* at 458-59.

⁷⁰ See Willis, *supra* note 28, at 260-82.

investing it in debtors' fresh start or the local real economy? Moreover, as the surveys reported here show, debtors have unjustified confidence in their newfound financial knowledge after these courses. Debtors who believe that they understand sound financial management practices, but who do not actually understand them, are more dangerous than those who remain ignorant. The illusion of control is empowering, but that overconfidence might well produce more financial distress in the future.

The principle teaching vehicle in a personal insolvency procedure is the experience itself. When debtors experience the consequences of whatever risks they have taken, they are much more likely to internalize those lessons and behave in a less risky way in the future. The school of life is the most effective at delivering the message of the importance of financial responsibility. Attempts to enhance or artificially reproduce these lessons are destined for failure, or worse.