Financial Services

The Next Chapter: Bankruptcies after COVID-19

As the foreclosure and eviction holds and forbearance protections are lifted, we expect a large influx in loss mitigation and bankruptcy filings. This could result in under-prepared bankruptcy departments being unable to keep up with volume. In addition, this will likely raise the cost of servicing and extend foreclosure timelines.

There are many ways that mortgage, auto, and other loan servicers can prepare for an increase in bankruptcy filings over the coming weeks, months, and, potentially, years.

Servicers should use this time to prepare for the expected uptick in bankruptcies and evaluate the following questions:

- What additional staffing or outside support do you need to address a surge in bankruptcy volume?
- Can portions of the process be automated or outsourced?
- Do you have the capability to track, monitor, and implement any changes to laws and regulations?
- What controls, testing, and continuous monitoring exist to help prevent any regulatory issues?

With government support programs ending, there will likely be an increase in consumer bankruptcies flowing into a bankruptcy system. What challenges will the consumer finance industry see from this influx of bankruptcies and how can they emerge and ultimately flourish?

How COVID-19 is Shaping the Consumer Landscape

At the onset of the global COVID-19 pandemic, the United States saw approximately 33.5 million unemployment filings over the course of less than two months.[1] This is one component of the expected financial fallout of a multi-month impact on the American economy. Many businesses saw full or partial shutdowns leading to massive layoffs and furloughs that resulted in household wage reductions.

With multiple weeks of limited business and diminished revenue, consumer businesses such as restaurants, retail shops, movie theatres, and airlines are slowly reopening, with significant limitations. When the economy will return to pre-pandemic levels is unknown — some believe the economy may see extended impact through 2020 into 2021.

Potential Long Term Impacts

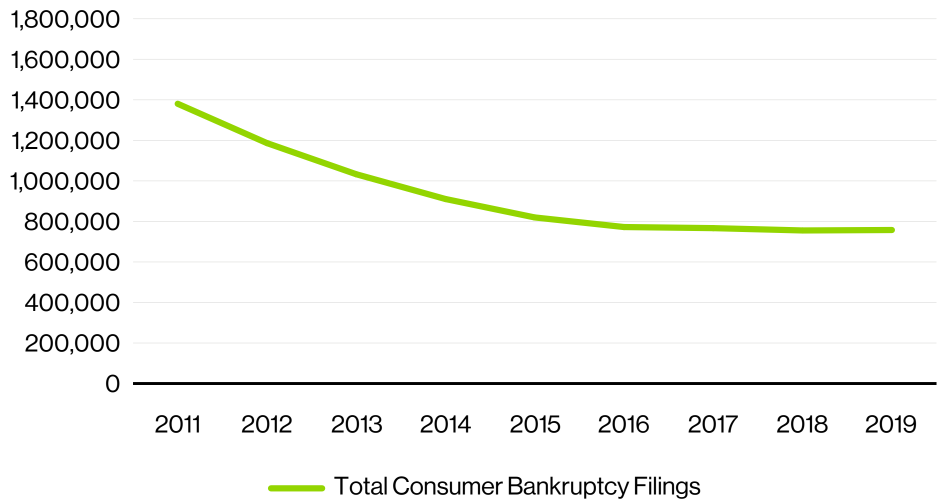
- Slow return to full staffing at consumer businesses will lead to continued jobless claims.
- Consumer demand may not return, resulting in prolonged unemployment.
- Borrowers will be behind on both secured and unsecured debts.
- Borrowers dipping into savings will not have a safety net should personal disruptions such as hospitalization or other unforeseen expenses occur.
- Personal bankruptcy may become a sought-after solution for borrowers to obtain relief from debts and a fresh start after the pandemic.

1. U.S. Department of Labor news release, "Unemployment Insurance Weekly Claims," May 14, 2020, https://oui.doleta.gov/press/2020/051420.pdf.

History of Bankruptcy Filings

Bankruptcy filings change over time due to many external factors and are largely tied to the overall economy and employment. As you can see in Table 1, since 2011 and the end of the Great Recession, there has been a downward trend in bankruptcy filings through 2019.[2]

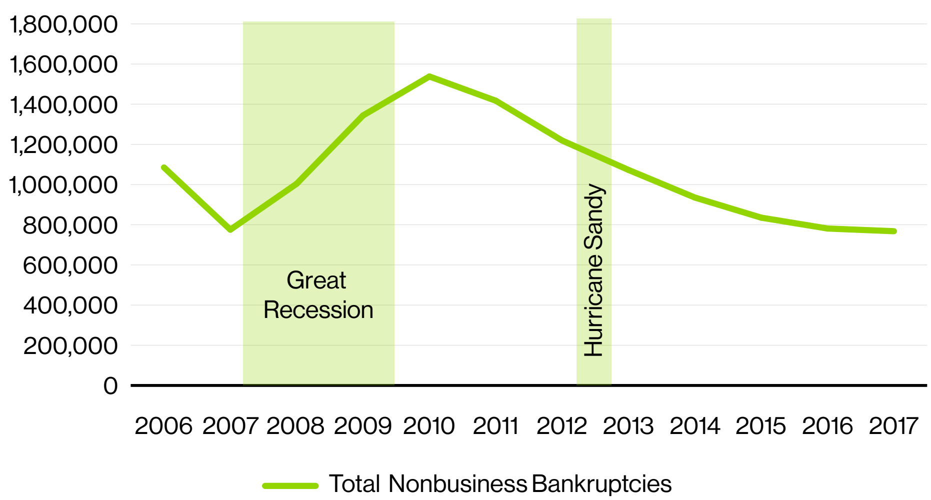
Table 1: Consumer Bankruptcy Filings from 2011-2019



Additionally, filings through March 2020 also saw a 5% drop year over year against the filings of 2019 in the same period.

There was little indication of a bankruptcy problem on the horizon, going into the second quarter of 2020. Table 2 provides the time frame from 2006 to 2017, which covers the Great Recession. The Great Recession aligns with a very significant increase in nonbusiness bankruptcy filings. However, more localized events like natural disasters (e.g., Hurricane/Superstorm Sandy in 2012) did not have a significant national impact.

Table 2: Total Nonbusiness Bankruptcies from 2006 to 2017



2. Automated Access to Court Electronic Records, March 2020 data; includes Chapter 7 and Chapter 13 filings.

How can we use this information to plan? Unlike a natural disaster, the coronavirus has had a worldwide impact and is likely to manifest similarly to the Great Recession. There are, however, some specific distinctions in this scenario vs. the Great Recession:

- This time it's not all about the mortgage industry. Because the issues are external to the industry, it appears the banking industry is relatively strong, and the housing industry in particular continued to show demand months into the pandemic, quickly giving hope to mitigation of increased bankruptcies through temporary policy measures (by the government) and loss mitigation efforts (by investors and servicers),[3] although it's unclear if this will be maintained.
- While job losses hit very suddenly, unemployment filing counts have subsided.
- Mitigation activities have been aggressive, leveraging lessons learned from the Great Recession, largely through Coronavirus Aid, Relief, and Economic Security (CARES) Act initiatives.
- Forbearances have been used much more widely and quickly, with 4.75 million homeowners (9.0% of all mortgages) in COVID-19 mortgage forbearance plans, as of May 19, 2020.[4]

Although the current economic scenario is most like the Great Recession, there are key differences that are already impacting current bankruptcy filings. Unlike the Great Recession, borrowers have benefited from CARES Act support, including forbearances, foreclosure, and evictions moratoriums, and money received from the Paycheck Protection Program. Not all areas of the country have seen housing value impacts[5] from the pandemic. The true impacts of these programs will take a long time to understand. Are they just delaying the inevitable or will the interventions decrease the bankruptcy burden in the long term?

Challenges

Servicers should be mindful of the potential for a significant increase in defaults, personal bankruptcies, and foreclosures, which will lead to the increased cost of servicing customers and higher servicing losses as we emerge from the pandemic.

Cost of Servicing Impact: Bankruptcy, foreclosure, and loss mitigation will drive increased servicing costs. Underlying challenges include:

- Understanding total servicing costs due to the difficulty of monitoring.
- Evaluating and prioritizing servicing investment to mitigate bankruptcy risk and drive return on investment.
- Managing the nuances of bankruptcy laws and regulations — while managing multiple workflow systems and data platforms — makes automation, coordination, and workflow management difficult.
- Having the appropriate levels of staff and outside support so you can handle the volumes but also not have idle workers.

Capacity Constraints Within Bankruptcy Departments: Current bankruptcy teams may not have experience with large volume spikes and the need to prioritize. Identifying the expected volumes in types of bankruptcy (Chapters 7, 11, or 13) may prove difficult due to unprecedented markets. Potential roadblocks may include:

- In-house staffing may struggle to keep up with unpredictable volume increases. Due to bankruptcy nuances, increasing staffing can require significant training and/or increased costs to hire seasoned professionals.
- Reestablishing and expanding relationships with vendors and continuing appropriate oversight to ensure service level agreements and quality are sustained, especially for attorney firms, to ensure partners can handle increased volume.
- The ability of in-house and key vendor technology solutions to support scaling of operations and workflow.

Impact of Increased Servicer Losses: Delays in the bankruptcy legal process from bankruptcy through foreclosure and real-estate owned will likely increase losses by servicers. Challenges may include:

- Forbearance and loss mitigation considerations in bankruptcy can delay timelines.
- Court delays and interjurisdictional differences leading to inefficiencies with attorney firms.
- Changing rules can cause confusion between partners and later write-offs (e.g., CARES Act rewrote some of the bankruptcy code and other proposals about rewriting the code, including those related to COVID-19 or even student debt). With the excuse of the crisis, there will likely be additional bankruptcy code changes.

3. Brad Hunter, "The Housing Market Is Rebounding, But What Happens After Stimulus Support Measures Fall Away?" Forbes, June 10, 2020, https://www.forbes.com/sites/bradhunter/2020/06/10/a-residential-reboundbut-what-happens-after-the-supports-fall-away/#21ad8cd42cbd.
4. Black Knight, "4.75 million homeowners now in COVID-19-related forbearance plans," May 22, 2020, https://www.blackknightinc.com/black-knight-4-75-million-homeowners-now-in-covid-19-related-forbearance-plans-nearly-half-made-april-mortgage-payments/.
5. Shaina Mishkin, "The Housing Market Shows 'Continued Strength and Resiliency,'" Barron's, August 4, 2020, https://www.barrons.com/articles/the-housing-market-shows-continued-strength-and-resiliency-corelogic-says-what-that-means-for-home-prices-51596553329.

While the Post-Pandemic Economy Continues to Take Shape, There Will Likely Be an Uptick in Bankruptcy Filings for Consumer Lenders/Servicers

Servicers may elect to use the current downtime to think about the following:

- Support loss mitigation efforts to reduce losses, including short sales and deed-in-lieu programs as a foreclosure alternative
- Perform active bankruptcy population monitoring
- Support cost-saving initiatives through automation and process optimization
- Ensure the team of bankruptcy experts is well-versed in technology available to support their likely increase in workload
- Identify a partner to support excess capacity through a managed services center

Contacts

Christopher Sicuranza
Partner and Head of the Banking, Insurance and Capital Markets Practice
(202) 973-6545
csicuranza@guidehouse.com

Matthew Moosariparambil
Director
(202) 481-8624
Matthew.Moosariparambil@guidehouse.com

Sara Laskoski
Associate Director
(202) 973-6516
Sara.Laskoski@guidehouse.com

Special thanks to **Kyle Saltzberg** for contributions to this paper

Guidehouse