Managing Health: The Key to Credit Quality

The Problem:

1. **70% of Americans** with medical bills had to forego spending on food to avoid bankruptcy. Medical debt is the most prevalent collection item on consumer credit reports at 58% of all collection items in the 2nd quarter of 2021.
2. Medical bankruptcies represent **62% of all personal bankruptcies**. There were 413,616 bankruptcies in 2021, down from 544,463 bankruptcies in 2020.

Medical debt and bankruptcy are unique. Roughly 20% of Americans (66MM) report having medical debt, but a small fraction of that end in bankruptcy. Medical debt is often the entry point and, in many cases small amounts, while bankruptcy is the worst-case exit and, in most cases involves significant assets.

However, there is very expensive process in between. It is the continuous stream of growing delinquencies that lead to workouts, foreclosures, repossessions, arbitrations, court cases, and ultimately bankruptcy. It takes time, involves people, and is expensive.

Mortgage and auto loans depend heavily on collateral. Risk mitigation depends on rapidly getting physical control of an asset after a default. Condition of the collateral is problematic, and in the case of autos often difficult to locate. (Unsecured credit cards are typically written off after 6 months.)

The NY FRB's 4th quarter 2021 Consumer Credit Panel covering $10.9T in Mortgage debt found .3% went 90 days past due each quarter, down from .7% per quarter a year earlier. For $1.6T of auto debt the seriously delinquent rate was 1.6%, down from 1.8% a year earlier. For the $.9T credit card debt the seriously delinquent number was 3.2%, down from 4.1%.

The steam of serious delinquencies looks small on a monthly or quarterly basis, but the expense is cumulative. It starts accumulating 90 days earlier, buried within a much larger number of missed first payments. In fact, for 30-year mortgages and 5-year auto loans the damage may already be in motion years before any missed payments.

An Alternative

As with physical health, if you wait until the illness is evident and undeniable, it's already broken and expensive to fix. In the medical situation, scheduled checkups can detect problems in time to take preventative measures. Acting early save lives and avoids high-cost emergency treatments. Healthy people can also find health insurance easily, and it costs them less when they do.

Commercial loans use the alternative model. They are based on *income as the first and primary source of repayment*. Collateral is nice, but not sufficient. The cost of liquidating a company can easily exceed to amount of the loan. Workouts can take years, perfecting and managing liens is expensive, write-offs are large and lumpy, lawyers and long judicial processes kick in.

The weaker the income and liquidity of the company the more the loan costs. If it is too dependent on collateral, lenders will be scarce and expensive.

Commercial lending is like health insurance. There are scheduled check-ups and reviews, even for collateralized (less healthy) ones. There are covenants that trigger corrective actions well before a maturity or review dates. The same is true for large personal loans connected to private businesses.

The Dilemma

None of this is practical for the bulk of consumer loans. Mortgage and auto loans are long term commitments. Regular (let alone audited) financial statements are not readily available. If they were, processing them would be impractical, and ejecting people from their homes is difficult and unpalatable.

The decision to lend depends on a single snapshot in time, a historical credit score, and perfecting a lien. Once the loan is made the “hoped” for source of repayment is income, but there is no test and no assurance. Managing mortgage and auto loan portfolios is based on large numbers of loans for similar amounts and understood probabilities.

They are more like life insurance than health insurance. Life insurance has an intensive underwriting process up front. It is priced based on probabilities and large numbers of policies with similar amounts. Once placed it continues if premium payments are made.

A Hybrid Approach

Banks already use mortgage insurance (a form of life and disability insurance) to backstop the health of mortgage borrowers with less than 20% equity in the home. There is no prohibition on applying practices from health insurance to loans and borrowers as well.

Medicare Advantage, employer health plans, and long-term care polices all provide examples of encouraging health and safety practices to maintain active independent lives if possible and to minimize sickness and accidents.

Those objectives align well with consumer lenders’ preference for income generating (healthy) borrowers. Healthy borrowers with healthy income streams are the best source of repayment, regardless of the collateral. In a sense helping borrowers stay healthy, manage medical situations, and perform necessary caregiving functions makes the mortgage insurance redundant.
Mortgage insurance already acknowledges a direct connection between the health of the borrower and loan quality for the riskiest mortgage customers – and embeds the cost in the mortgage pricing. The questions are, why limit the rational to the riskiest customers? What would a preventative service look like? Who would pay for it?

A Sample Model

Fraud and identity theft mitigation programs are time-tested plug and play approaches to *"asset protection".* A stolen identity puts virtually all assets at risk, and that can impact whole families. Educating members, increasing their awareness, and providing tools that empower them to stop damage before it starts, works. Stopping the damage of theft or fraud before it starts is far better than clawing back assets after they are gone.

For *"income protection"* the largest threat is health quality, capacity, and capability – rather than fraud and identity theft. Education, awareness, and tools still provide the means to stop damage before it starts. And it also impacts the whole family, the person who is ill, the person who provides care, and the people who depend on either of them.

Covid has demonstrated family impact conclusively. Empowering people to protect their earning capability is more important in a Pandemic, but it is always important. The challenges existed before the virus and will extend well beyond it.

Medical Conditions Treated as a Gateway Consumer Debt Problem

Often it is a billing error or a delay in processing multiple levels of insurance and responsible parties. A monitoring and resolution support service could add value. People fear surprise bills. People are confused by billing systems they don't understand.

Accessible simple "one-page helpers" for medical issues can provide actionable help to control a health situation and reduce the need for excessive medical expense. It takes time and effort to understand and implement a treatment plan. Simplifying that facilitates adoption.

Acute medical events often lead to caregiving requirements. Patient and caregiver both face unexpected stress and unplanned expenses. Both can benefit from support and/or advocacy to expedite getting the best, most cost-effective support structures in place.

Medical events are often tied to disaster preparation and response. Support to prepare and respond may keep health conditions or events from spinning out of control and costing more when they occur during abrupt changes to living situations.

Concierge medicine or Telemedicine can provide easy access to guidance and short circuit delays, worse results, and higher costs.

These or other similar tools need not be expensive. Many can be bundled with existing products and services to differentiate them. They can be offered as features in a premium product or offered for sale as an upgrade feature. Coupled with personal advocacy and/or local partners' services the scope can be expanded to a concierge health and wellness service. The possibilities are numerous.

The questions for a credit union to answer:

1. Mission question: Will you help members protect their income, not just your asset?
2. Retention question: How much will you increase member engagement and loyalty by aligning members' and your interests even more clearly?
3. Marketing question: How much share of market and wallet will you gain with a differentiated brand that places both health and financial wellness of members first?
4. Bottom-Line question: How many medically caused bankruptcies, foreclosures, and repossessions can you avoid by going past the balance sheet to help members protect their income?
5. What's your starting point? It can be large or small in scope but keep it simple. Start from where you are. Look outside first (there is a lot available for little cost). Empower an effective advocate. Experiment to learn and practice. Adjust, increment, and repeat.

DSG helps financial service firms integrate wealth and health to strengthen relationships, grow sustainable revenue, and benefit clients' financial and personal wellness.

By: J Heywood E Sloane,
Principal, Diversified Services Group, Inc
heywoods@dsg-network.com