The Daily Dish

Magically Disappearing Medical Debt

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Let's review the lending basics. Whitney comes to me interested in borrowing the money to purchase a case of Twizzlers. She has a steady job, solid income, no history whatsoever of failed debt payments, and no outstanding debt. (There's pretty good collateral too!) Happy to do it.

Jason is no Whitney. He wants Twizzlers, too, and his job and income are fine. But his financial history is full of failures to repay in full previous loans and he has a large amount of debt outstanding. I decide no.

That, in a nutshell, is how credit decisions are made – on the basis of the current financial condition and credit history of the potential borrower. Makes sense.

This issue arises because the Office of Management and Budget (OMB) issued a MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES entitled "Further Addressing the Impact of Medical Debt on American Families." By "addressing" the administration means: "For direct loan and loan guarantee programs that focus on consumer loans or small and medium businesses where a consumer's credit history is a factor, agencies must develop a plan to eliminate medical debt as a factor for underwriting in credit programs…."

This is a very big deal. Had it been applicable in the Twizzlers lending, it might be the case that Jason's outstanding debt and history of failures to pay would be suppressed. Jason and Whitney would be treated as identical, and I would have put funds at risk by lending to Jason. In this case, however, it would be the taxpayers' money that is being put at risk. It is particularly odd because medical debt is simply debt – dollars owed to a lender. And failure to pay medical debt is simply failure to pay debt. Putting "medical" in front of it doesn't change the financial calculus at all. And for debt purposes it is no different from any other kind of debt. What will be next, forgiving auto debt?

The memo is evidently the follow-up implementation for the "New Actions to Lessen the Burden of Medical Debt and Increase Consumer Protection" announced by Vice President Harris on April 11. The fact sheet makes it clear that the administration has a particular animus toward medical debt and disputes the "dollars are dollars" financial math: "The latest research finds that owing medical debt is not a reliable predictor of overall financial health. An analysis of 5 million anonymized credit records found that consumers who owed medical debt paid their bills at the same rate as those who did not. In fact, including paid-off medical debt causes credit scores to underestimate creditworthiness by as much as 22 points. As a result, the inclusion of medical debt on credit reports and in credit scores and loan underwriting can hold Americans back from financial opportunities while failing to improve the accuracy and predictiveness of lending programs."

Not so fast. The statement "including paid-off medical debt causes credit scores to underestimate creditworthiness" has nothing to do with "the inclusion of medical debt on credit reports and in credit scores and loan underwriting can hold American's back." *Paid off medical debt is no longer medical debt*; it has been paid off. It is not even a close cousin to actual medical debt that would indicate a reduced ability and propensity to repay and would legitimately limit borrowing. More generally, there is simply no consensus on the numerical importance of medical debt in overall consumer debt and probability of bankruptcy.

The whole initiative is designed to reduce the information available to lenders to make decisions. This will, by definition, not improve the assessment of creditworthiness and will likely impair lending decisions across the federal government. It is a terrible idea.