Finances - Debt

Note: The Financial Considerations adjudicative guideline identifies three very different types of security concerns relating to finances -- a high burden of debt, unexplained affluence, and compulsive gambling. For purposes of discussion in this desk reference, it is useful to discuss these three concerns separately. This topic deals only with debt. Unexplained affluence and compulsive gambling are covered in separate topics, Finances - Affluence and Finances - Gambling.

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Relevance to Security

Common sense and experience tell us that financial difficulties may increase temptation to commit illegal or unethical acts as a means of gaining funds to meet financial obligations. Many persons encounter financial problems through no fault of their own. For others, financial problems appear to be part of a general tendency toward irresponsibility and poor judgment, and that is a security concern. From a security perspective, the cause of debt and how one deals with financial obligations are considerably more important than the amount of debt.

It is important to remember that many financially motivated crimes are committed out of simple greed, not need, and that most people with financial difficulties are not inclined to commit illegal acts at all.

Potentially Disqualifying Conditions

Extract from the Guideline

(a) inability or unwillingness to satisfy debts;

(b) indebtedness caused by frivolous or irresponsible spending and the absence of any evidence of willingness or intent to pay the debt or establish a realistic plan to pay the debt.

(c) a history of not meeting financial obligations;

(d) deceptive or illegal financial practices such as embezzlement, employee theft, check fraud, income tax evasion, expense account fraud, filing deceptive loan statements, and other intentional financial breaches of trust;

(e) consistent spending beyond one's means, which may be indicated by excessive indebtedness, significant negative cash flow, high debt-to-income ratio, and/or other financial analysis;

(f) financial problems that are linked to drug abuse, alcoholism, gambling problems, or other issues of security concern;

(g) failure to file annual Federal, state, or local income tax returns as required or the fraudulent filing of the same;

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Significant Unpaid Debts

The degree of security concern about unpaid debts depends upon:

- Cause of Debts
- Amount of Debt
- Attitude Toward Debts
- Illegal Financial Practices as a result of the debt.

The cause of debts and action taken (or not taken) to pay debts tells far more about a person's reliability, trustworthiness, and judgment than the amount of debt. A person making a good faith effort to pay off a large debt caused by unexpected medical expenses or business reverses, for example, is unlikely to be a security concern. A person who has made no effort to pay off a much smaller debt caused by financial irresponsibility may be a security concern.

The seriousness of a financial issue is significantly increased if there is misconduct or character weakness of the type considered under other adjudication criteria. Most people with serious financial difficulties do not commit crimes in order to gain money to pay their debts. The few who do are those who have serious financial difficulties *and* significant character weaknesses or psychological problems. The *combination* of financial problems and character weaknesses or psychological problems as shown by various forms of misconduct is a serious concern.

For some persons, financial problems are caused by underlying emotional problems. For them, the issue is not as simple as having too little income or too many expenses. And the solution is not as simple as earning more income or going through bankruptcy to relieve debt.

Money has strong symbolic value, in addition to its value as a medium of exchange. Some individuals have a compulsive need for money or goods as a source of self-esteem, power, control, or security. Much less common is a compulsive aversion to money, when people are at ease with themselves only when deprived or in debt.

The book *When Money is the Drug: The Compulsion for Credit, Cash, and Chronic Debt* offers a good understanding of how and why many people behave irrationally with respect to money.1 It provides a nontechnical description of personality disorders associated with money -- compulsive spending, compulsive debting, compulsive greed, compulsive hoarding, and compulsive deprivation.

Cause of Debts

If the subject is not at fault for the financial problems and is handling them in a reasonable manner, including bankruptcy, the significance of the security issue is substantially reduced. On the other hand, if the debts were caused by irresponsibility or a personal weakness that is likely to continue and may cause other security or performance problems, the significance of the financial issue is magnified.

Circumstances Beyond the Individual's Control: According to a Harvard University study, nearly 90% of families with children who file for bankruptcy cite one of three reasons: job loss by either husband or wife, family breakup, or medical problems. Other causes of debt that may be outside the individual's control include bad investments, being the victim of a crime, and natural disasters.2 The financial issue may be mitigated if there is no clear personal fault and subject has responded to the indebtedness in a reasonable and responsible manner. See Mitigating Conditions.

Irresponsibility: Financial debt caused by impulsive or irresponsible spending or chronically poor judgment is a serious issue, especially if the debt is burdensome. This type of behavior should also be evaluated under the Personal Conduct guideline.

Compulsive or Addictive Behavior: Any debts caused by gambling, drug abuse or alcoholism are a serious concern. Addictive or compulsive behavior often leads to impaired judgment and may lead to illegal or unethical acts in a desperate attempt to recover from self-inflicted financial adversity. Compulsive gambling, in particular, often leads to fraud, embezzlement, and other crimes. Extensive information is available on indicators used to identify compulsive gambling and on the prevalence and consequences of compulsive gambling. See Finances - Gambling. Some psychiatrists now believe that compulsive shopping is a specific, treatable mental disorder. 3

Greed: Debt caused by avarice or grandiose behavior is a serious concern. A pattern of spending to make an impression on others, to support one's self-esteem, or to maintain a standard of living beyond what one can afford, indicates that the subject may be susceptible to future temptations for illicit gain.

For related information, see Credit Counseling.

Amount of Debt

Amount of debt determines, in part, how much stress or desperation an individual feels as a result of financial problems. Stress or desperation is influenced by the reason for the debt (e.g., shameful gambling losses versus medical expenses for sick child), aggressiveness of creditors in collecting that debt, embarrassment that would result from collection efforts, and whether the subject has concealed the debt from spouse or other close family members.

Length of time a debt is overdue is an important consideration. There are many scenarios that might cause a debt to be 30 or even 60 days overdue for reasons that are beyond the subject's control. The longer a debt is overdue, the greater the likelihood that the subject is either unwilling or unable to pay the debt. Even if the amount of debt is below some threshold for what might be considered acceptable, it may still be disqualifying if there are multiple debts that show a pattern of irresponsibility.

Bankruptcy: Bankruptcy is a legal means of liquidating past debts. Debts liquidated through bankruptcy proceedings should not be counted under amount of debt. The significance of past bankruptcy proceedings depends on what the bankruptcy shows about an individual's judgment and reliability in dealing with financial obligations. The cause of the financial problems and what efforts the subject made to solve the problems short of bankruptcy are more significant than the amount of debt. If financial problems continue after debts have been liquidated by bankruptcy, this may be evidence of financial irresponsibility and may also be evaluated under the Personal Conduct and/or Psychological Conditions guidelines.

Maxing Out of Credit Lines: Credit card debt that is continually at or near the limit of the individual's credit lines may be a concern even if the minimum monthly payments are current and the credit report is otherwise favorable. An ongoing pattern of maxing out the credit lines suggests a habit of living beyond one's means that portends future problems. The subject is either being irresponsible or is under pressure from at least as much debt as he/she can handle, and possibly more. It can also indicate unexplained affluence when the amount of monthly payments on credit accounts is greater than one might logically be able to afford. This was the case with Soviet spy Aldrich Ames, whose minimum monthly payment on credit accounts was greater than his monthly CIA salary.

Debt-to-Income Ratio: The debt-to-income ratio is a widely used rule of thumb for judging a person or family's financial condition -- whether income is sufficient to pay off debts. Debt-to-income ratio is calculated by dividing monthly debt payments (including credit cards, personal loans, car or student loans, medical bill payments, and alimony or child support payments but excluding mortgage or rent payments) by monthly income (including gross earned income, investment income, and alimony or child-support income). For example, a monthly debt obligation of $800 divided by a monthly income of $4,000 is a debt-to-income ratio (excluding mortgage) of 20%. If an individual's debt-to-income ratio (excluding mortgage) is greater than 20% of monthly income, credit counselors typically see this as a cause for potential concern about an individual's financial stability. 4, 5

Mortgage lenders calculate the debt-to-income ratio a little differently from credit counselors. They include the future mortgage payment among the monthly debt payments, and this results in a higher ratio. Most mortgage lenders require that applicants have a debt-to-income ratio of "28/36" or better. This means that no more than 28 percent of your total monthly income (from all sources and before taxes) can go toward housing, and no more than 36 percent of your monthly income can go toward your total monthly debt, which includes the planned mortgage payment). The debt they look at includes any longer-term loans like car loans, student loans, credit cards, or any other loans that will take a while to pay off. This ratio can vary somewhat depending on the down payment, the type of loan, and the interest rate.6 In some geographical areas of the country, the high cost of real estate may require people to apply more than 20% of their gross income to housing expenses.

Adjudicators analyzing amount of debt should also consider the following points:

Limitations of Credit Reports: It may be necessary to go beyond the credit report to gain a full understanding of a subject's financial status. Many forms of debt never appear on the credit report and that which is reported may be inconsistent or incomplete. For information on types of debt that do not appear on the credit report, see Limitations of Credit Reports. For help in reading credit reports, see Glossary of Credit Abbreviations.

Payment of Delinquent Accounts: If a Statement of Reasons or Letter of Intent to deny or revoke clearance approval is issued due to delinquent accounts, the subject may pay those accounts and submit proof as part of an appeal or rebuttal. Two questions then arise. (1) Is payment of the debts sufficient to eliminate the issue? This depends on whether the debts were incurred, or allowed to become delinquent, as a result of personal irresponsibility. Evidence of past irresponsibility is not erased by payment of debts only under pressure of qualifying for a security clearance. (2) If the amount of debt is sizable, where did subject get the money to pay the debt? If the subject cannot account for the source of money to pay the debts, unexplained affluence may be an issue. This is illustrated by the case of Thomas Cavanaugh, a Northrop employee who in 1985 tried to sell information on the Stealth bomber to the Soviets. He was motivated, in part, by what he perceived as a need to pay his debts to protect his security clearance. He was concerned because he was having financial problems and was due for periodic background reinvestigation. 7

Disputed Debts: If a subject has formally disputed a debt (e.g., written the creditor, hired an attorney, initiated a court action) prior to adjudication proceedings, the adjudicator may elect to disregard this debt until the issue is resolved. However, if the investigation identifies a delinquent debt and the subject denies the delinquency, the burden of explaining, rebutting, or mitigating the adjudicator's findings remains with the subject. If the subject claims that a long-standing delinquent debt has been paid, the subject should, in most cases, be required to show proof of payment. A claim that a debt will be paid soon is irrelevant until the debt is actually paid.

Repossession: Repossessions normally occur only after the subject has been given repeated opportunities to become "current" with the payments and failed to do so. After a car or other item purchased on credit has been repossessed, there will often be a balance due even after the lender has recovered and sold the item. This balance will normally be shown as a charge-off on the credit report. However, many lending institutions fail to notify the individual that a balance is still due. If the subject has not been notified, this balance should not count against total debt if the subject is otherwise making debt payments in a responsible manner.

Relationship to Other Guidelines: If the subject has demonstrated financial irresponsibility or a disdain for paying legitimate debts, this may also be considered under the Personal Conduct guideline regardless of amount of debt. For example, if he or she pays delinquent debts only after learning that the debts may cause an adverse personnel security determination, this may be noted under Personal Conduct regardless of the amount of debt. Any deliberate refusal to pay a debt one can afford to pay is a significant concern under Personal Conduct. The combination of such financial considerations with other indications of irresponsibility, rule-breaking, or other forms of undesirable behavior increases the concern about a person's reliability and trustworthiness.

Attitude Toward Debts

How the subject deals with debt is often a decisive consideration. Disdain for fulfilling financial obligations may be disqualifying even if current delinquent debt is relatively small. A person who is unconcerned about financial obligations may also be unconcerned about fulfilling other obligations, such as obligations to protect classified information.

A subject with an acceptable credit rating who has shown evidence of being unconcerned about fulfilling financial obligations can be a greater security concern than a subject with a poor credit rating who is striving to pay his or her debts.

If the subject demonstrates lack of concern about financial obligations, this can also be considered under the Personal Conduct guideline or the Psychological Conditions guideline. The behavior may be part of a broader pattern of irresponsible or antisocial (rule-breaking) behavior.

History of Debt: A history of bad debts, garnishments, liens, repossessions, foreclosures, unfavorable judgments, delinquent or uncollectible accounts, or debts written off by creditors as uncollectible losses, regardless of the amount owed, is potentially disqualifying if the subject made little or no apparent or voluntary effort to pay the amounts owed. Example 1

Irresponsible or Fraudulent Financial Behavior: Irresponsibility toward financial obligations may be indicated by failure to take reasonable measures to pay or reduce debts. Fraudulent financial behavior includes using deceit or deception to obtain credit, going on a credit card spending spree just before filing for bankruptcy, changing one's address without advising creditors in an effort to escape payment, using credit card debt wantonly when one knows that repayment is unlikely, knowingly writing bad checks, writing a check on a previously closed account, or skipping from an apartment without paying rent.

Actions taken with respect to federal student loan and court-ordered child support payments may be an indicator of irresponsibility toward financial and social obligations in general. Some individuals with an otherwise good credit record try to get away with not making student loan or child support payments, and this indicates less than desirable behavior toward financial obligations. Delinquencies on federal student loans and child support payments often do not show up on credit reports.

Significance of Bankruptcy: The significance of bankruptcy depends upon the cause of the bankruptcy. When the subject was not at fault for the financial problems, the issue may be mitigated. If bankruptcy was due to financial irresponsibility and such irresponsibility has continued after the bankruptcy, this is a very serious concern. The credit report covering the period after the bankruptcy may contain clues to the subject's post-bankruptcy behavior. If debts again build to the maximum of the available credit, this suggests continuing financial irresponsibility.

Concealment of Debt: If the cause of the debt is so embarrassing that the subject conceals it from his or her spouse or other close associate, this is a very serious concern. For example, if the subject has lost the family nest egg through addiction to alcohol or drugs, compulsive gambling, compulsive shopping, high-risk investments, or simply by poor financial management, this may be concealed from a spouse if it threatens the person's self-esteem. Under such circumstances, there is a significant risk of illegal actions in an effort to recoup losses. The subject may also be vulnerable to pressure as a result of the debt.

Feelings of Entitlement: Some individuals have unreasonable feelings of *entitlement* to more money just because they need it so badly, work so hard, or because others have it. Unreasonable feelings of entitlement to money are a security concern because they lead to easy rationalization of theft, fraud, or other illegal activity for monetary gain. The subject may rationalize that "I'm only taking what I'm owed, or what I deserve."

There has been a general change in attitude toward debt during the past 15 years. Since 1990, the debt-to-income ratio of the average American family has increased steadily. After adjusting for inflation, median income has increased only 11% in the past 15 years, while spending and household debt have increased 30% and 80%, respectively.8 This increased debt level is putting increased financial pressure on the average American family.

Credit Card Debt

Credit card debt beyond one's ability to pay is a principal source of financial stress for American families. It is the type of debt that is most likely to cause Americans to file for bankruptcy, and it is responsible for the large increase in frequency of bankruptcy.

According to a 2003 report, the number of bank and retail store credit cards in the hands of Americans more than doubled between 1980 and 1999, growing from 116 million cards in circulation to over 262 million. Between 1989 and 2001, the amount of credit card debt almost tripled, from $238 billion to $692 billion. In April 2005, American credit card debt was believed to be a staggering $2.12 trillion. Also between 1980 and 2001, the savings rate steadily declined, and the number of people filing for bankruptcy increased 125%, from 616,000 filings in 1989 to 1.45 million filings in 2001. In 2005, this increased to over 2 million filings. Although Americans have experienced a period of high prosperity in the last two decades, many lower- and middle-income Americans have been affected by stagnant or declining wages, job displacement, and rising health care and housing costs. More and more Americans are using credit cards as a way to fill the gap between household earnings and the growing cost of essential goods and services. 9, 10

A Harvard University study attributes a surge in middle-class bankruptcy to what it calls "the two-income trap." Because of the increased cost of housing, day care, and health insurance, the average two-income family has less discretionary income today than a single-income family had in the 1970s. If one spouse is laid off, unable to work, or no longer contributes to the family due to separation or divorce, the family is at high risk of having financial problems. Credit card debt accumulates just to pay for essentials such as groceries, insurance, and gas. 2

One organization that provides credit counseling and education services in the Maryland suburbs of Washington, DC, found that the average credit card and unsecured debt of its clients rose almost 50% from $52,210 in 2002 to $77,036 in 2003. The average client in 2003 came in with 11.3 credit cards, up from 8.1 in 2002; a negative monthly cash flow of $2,468, and 5.4 credit card late fees per month costing $169. This organization reported that:

"People are trying to fix their financial troubles by borrowing their way out of debt and creditors are happy to let them get in deeper. Today, debtors have significantly fewer options for resolving difficult financial problems without bankruptcy. Creditors have become more resistant to working one-on-one with people to develop plans that allow them to meet their obligations. Good people are falling to their financial death even though they want to meet their obligations in difficult times." 11

Since the mid-1990s, credit card promotions have increasingly targeted those with lower incomes who are most likely to make only minimum payments each month, carry high balances, and pay high interest rates as a result of late payment and other penalty fees. The minimum monthly payment was dropped from 5% of the credit card balance to 2% or 3%. Fees for late payments have increased to an average of $29 per late payment. Grace periods for late payments for many cards have gone from 14 days to zero days. Late payments are often used as an excuse to cancel low interest rates used to attract new cardholders and then increase these rates to anywhere between 22% and 29%. Since the mid-1990s, credit card use has grown the fastest among Americans with incomes less than $25,000 per year, and by 2000 approximately one-third of these low-income families spent at least 40% of their income paying back debt. Individuals who make only minimum payments are able to carry more overall debt but often find that their debt mushrooms out of control as a result of late fees and increased interest rates. 12

A 2004 Gallup Survey revealed that the average American household carries about $3,800 in revolving debt (debt that is carried over from month to month). Americans with household income between $75,000-99,999 report the highest average amount of debt, $7,896, while those who make less than $20,000 report the smallest dollar amount of debt, $1,377. These numbers, however, are quite misleading. Although the middle class tend to carry the highest dollar amount in debt, this is generally only about 9% of household income, while those who make less than $20,000 per year carry an average credit card debt equal to over 14% of their income. Twenty-nine percent of cardholders surveyed claim to pay off all outstanding debt every month, while over 50% carry a balance. The survey also revealed that approximately 20% of Americans do not own a credit card, 58% have 1-4 cards, and 19% report carrying 5 or more credit cards. 13

Federal legislation approved in 2003 will require debtors to pay a minimum monthly payment of up to 4% of their balance; the minimum monthly payment will require consumers to pay all fees and interest and at least part of the outstanding balance. This is aimed at helping debtors pay credit card balances faster, thereby decreasing total interest paid. This requirement is being introduced gradually by the credit card companies. Banks and consumers are both worried that the increase in required minimum payments will cause consumers to default at a higher rate when they are unable to make the required monthly payment, possibly forcing more consumers to file for bankruptcy. 14

Additionally, new legislation has been introduced that, if enacted, will require credit card companies to tell consumers, in detail on the credit statement, how long it would take them to pay off their current balance at their current rate making only minimum payments, and how much their total interest payments would be. The hope is that if consumers realize how long they will have to pay and how much of their payments are interest, they may be motivated to pay off balances faster. 14

See Credit Counseling for more information on this subject.

Credit Cards and College Students

A growing concern in the past decade has been the marketing of credit cards to college students, leading to what some experts call a student debt crisis.15 Credit card companies routinely market credit cards to college students, some as young as 17 years old, without first obtaining parental consent. While some students and parents alike see a credit card as a way to build credit, for many it has become a lifelong problem. Students are leaving college with more debt than ever before, especially when one considers that many students also take out student loans to help finance their education and must begin repayment within six months after graduation.

In 2004, 66% of college freshmen reported having at least one credit card.16 A 2004 study conducted by finance company Nellie Mae reported that the average student credit card balance was $2,169, and 43% of students reportedly owned four or more cards. For seniors, 91% reported having a credit card and the average senior carried more than five different cards. Of students surveyed, 21% reported that they paid off their credit card balance monthly, 44% reported paying more than the minimum payment but still carrying a balance, 24% make the minimum payment, and 11% said they make **less** than the minimum payment. 17

Credit card debt can be especially distressing for college students, many of whom are struggling financially just to stay in college. In 1998, a University of Indiana administrator admitted that the university lost more students to credit card debt than to academic failure; students are forced to drop out of school in order to work full time to pay off debts. 15

Mortgage Loans

Predatory lending practices in the mortgage industry have also contributed to the financial burden of many people. States' authority to regulate lending in their borders was eliminated by a federal regulation in the late 1970s, and this allowed interest rates to increase substantially. Mortgage lenders can lend to anyone and still make a profit, thanks to higher interest rates they are now able to charge. Many families who would qualify for lower interest loans are talked into higher rate loans by subprime lenders. Deceptive marketing practices are sometimes used to bait and switch the interest rate or utilize extra fees or hidden costs. Many lenders have been caught intentionally issuing mortgages to people who cannot afford them, with the ultimate aim of foreclosure and reselling the property for more than the outstanding loan amount. 18

Bad Checks

The significance of bad checks depends upon whether they were written knowingly, as a result of poor record keeping, or through no fault of one's own.

The greater the frequency of bad check incidents, the greater the likelihood that these incidents indicate irresponsible or unethical behavior. It is noteworthy, however, that multiple bad checks written within a single thirty day period could be a single incident under some circumstances. If the checks are written in anticipation of an automatic paycheck deposit being made on a certain date, for example, and the deposit is delayed, the single incident can cause multiple checks to be returned for insufficient funds. This is common with military personnel who move frequently and who change banks frequently.

Tax Liens

Tax liens are a concern because, in addition to the amount of debt involved, they show a failure to comply with government rules and regulations. This applies to state and local as well as federal taxes. Ability and willingness to comply with rules and regulations is important for the protection of classified information. There are times when the subject of investigation is not at fault for the lien. For example, it may be caused by complications resulting from divorce or marriage.

Child Support Payments

Failure to pay child support is a concern because it indicates either an inability or refusal to accept responsibility for the consequences of one's actions. The Child Support Recovery Act of 1992 made it a federal crime to fail to pay support for a child residing in another state. All reasonable available remedies must have been exhausted before prosecution is undertaken.

Failure to pay child support costs federal and state governments large amounts of money, as many single mothers must then depend upon Aid to Families with Dependent Children (AFDC) and other welfare programs. In order to place the burden for child support on the parents, Congress in 1975 established the Child Support Enforcement Program, which is implemented by the states under federal policy guidelines and standards and with largely federal funding.

Elements of the federal enforcement program include intercepting federal income tax refunds, helping establish paternity and getting support orders issued, operating the Federal Parent Locator Service, encouraging states to report child support information to credit bureaus, and changing the law to allow states to withhold wages and impose liens on property for overdue child support. Since 1994, child support obligations can no longer be erased through bankruptcy. 19

Student Loans

Default of federal guaranteed student loans may indicate financial problems, lack of respect for financial obligations, and/or lack of respect for government regulations, all of which are a security concern.

Default on federally guaranteed student loans peaked in fiscal year 1990 when 22.4% of all loans were in default. Aggressive efforts to reduce the default rate brought this down to 11.6% in fiscal year 1993 and to an all-time low of 5.4% in 2001. [20,21] The default rate varies greatly according to type of school attended. The 2002 default rate was highest for students who had attended public two-year schools and trade schools, with 8.5% and 7.3% defaulting, respectively. Rates were lowest for students from private four-year institutions (3.1%) and public four-year colleges (4%). [22]

Disputed Debts

Debts are often disputed, and it is sometimes difficult to distinguish fact from fiction when adjudicating these cases. The follow case is an example of this. It shows how, but focusing clearly on the adjudicative guideline, it is often possible to sort through a lot of conflicting information to make an appropriate decision.

Subject is a 45-year-old security guard. His Secret clearance is being reviewed. Subject has had problems with a car loan and credit card debt for the past five years. He states that his problems began when his car was stolen from him at gun point. The thieves also took his credit cards.

Although he had theft insurance on the car, the insurance company refused to pay his claim because they did not believe his car was really stolen. After the police found the car in damaged condition, subject allowed the lender to take it. After selling the car, the lender claimed subject still owed $1,069. Although subject has made no payments on the loan during the five years since the car was stolen, he states that he will satisfy the debt if the lender responds to his recent request for a status report on the loan.

Subject has five bank credit cards with a combined debt of about $12,000 that has been delinquent for almost five years. Subject states that about $9,000 of this debt was incurred before the credit cards were stolen and about $3,000 after he reported the theft of the cards. Although the banks have acknowledged that the cards were used after he reported them stolen, they have told subject that he must pay the entire balance.

Subject has not made any voluntary payments since the reported theft of his credit cards. One bank which holds three of the credit cards has obtained a judgment against subject for approximately $10,000, and subject's wages are now being garnished to pay this debt.

Subject explains that he has not paid these credit card debts for five years because his cards were stolen, the banks want him to pay for charges incurred after he reported the cards stolen, and the banks have not provided him with requested documentation on the debts.

Subject's clearance was revoked on the grounds that his explanation for his failure to pay debts for five years is not credible. Even if one accepts at face value subject's statements that (1) the insurance company refused to pay his claim, (2) that the banks insist he pay for charges incurred after he reported the cards stolen, and (3) the banks refuse to provide him with documentation, this does not justify subject's failure for five years to make voluntary payments on those debts that are undisputed.

Illegal Financial Practices

Deceptive or illegal financial practices such as embezzlement, employee theft, check fraud, income tax evasion, expense account fraud, insurance fraud, filing deceptive loan statements, and other intentional financial breaches of trust are a serious concern. Illegal financial practices will often lead to adverse administrative action unless the offense was very small or long ago. When the offender is a cleared employee, investigation should seek to understand the reasons for the offense. If the subject is in debt, is he or she at fault for the debt? Is this offense part of a pattern of minor or major rule violations by the subject? Is there a gambling, drug, or alcohol problem?

Illegal financial practices should be evaluated under the Criminal Conduct criterion and/or the Personal Conduct criterion, as well as under Financial Considerations.

Income Tax Evasion

Failure to file an income tax return when tax is due is a misdemeanor crime. It may also indicate financial problems, financial irresponsibility, or lack of respect for U.S. Government authority. Failure to file a tax return is more common among self-employed persons than among government or other employees whose salary is subject to tax withholding. Of the almost $28 billion in federal taxes that were not collected in 2002, over 50% is believed to be attributable to self-employed persons.23 However, failure to file occurs even among government employees, especially those whose financial situation is in considerable disarray.

A check of IRS master file records (not the individual Form 1040 files) on 44 Americans arrested for espionage during the 1980s found that 13 to 17 (29.5% to 38.6%) of them failed to file an income tax return during at least one year prior to their arrest. The exact number is uncertain, as in four cases it was not clear whether the individual actually was required to file a tax return during the year in question. In four other cases in which timely returns had been filed, tax payments were delinquent and the individual had significant difficulties with the IRS prior to arrest for espionage. 24

Mitigating Conditions

<u>*Extract from the Guideline*</u>

(a) the behavior happened so long ago, was so infrequent, or occurred under such circumstances that it is unlikely to recur and does not cast doubt on the individual's current reliability, trustworthiness, or good judgment;

(b) the conditions that resulted in the financial problem were largely beyond the person's control (e.g., loss of employment, a business downturn, unexpected medical emergency, or a death, divorce or separation), and the individual acted responsibly under the circumstances;

(c) the person has received or is receiving counseling for the problem and/or there are clear indications that the problem is being resolved or is under control;

(d) the individual initiated a good-faith effort to repay overdue creditors or otherwise resolve debts;

(e) the individual has a reasonable basis to dispute the legitimacy of the past-due debt which is the cause of the problem and provides documented proof to substantiate the basis of the dispute or provides evidence of actions to resolve the issue;

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The following supplemental information elaborates on these potential mitigating factors:

- **Not Recent:** Many immature young persons go through a period of some financial irresponsibility. The problems are often resolved as they mature and assume the obligations of steady employment or marriage. Past financial irresponsibility may be mitigated by a change to a more responsible lifestyle, including steady employment, reduction of credit card debt, and favorable change in financial habits over a period of time (generally one year). Other examples of a changed lifestyle that may affect a subject's finances are: destruction of credit cards, separation from a cohabitant or spouse that was causing financial problems, or a changed pattern of friendships or social activities.
- **Indebtedness Beyond Subject's Control:** Debt is often due to circumstances that are beyond a person's control. The financial issue may be mitigated if there is no clear personal fault and subject has responded to the indebtedness in a reasonable and responsible manner. The whole-person evaluation is relevant under these circumstances. A responsible person with good judgment and strong character is more likely to weather financial adversity without becoming a security risk than an individual with a record of immature, irresponsible, or rule-breaking behavior.

- **Receiving Counseling:** If the subject has participated conscientiously in credit counseling, a debt repayment program, or Debtors Anonymous or Gamblers Anonymous for at least six months, it is likely that the problem is being resolved. The National Foundation for Consumer Credit reports that about 65% to 70% of the individuals who start a debt repayment plan complete it successfully, and that the recidivism rate is low. For more information, see Credit Counseling. Claims that past delinquent debts have been paid off should be documented.
- **Good-Faith Effort to Repay:** Even without a formal credit counseling program, a person may make a good-faith effort to repay overdue creditors or otherwise resolve debts. One year of systematic effort to satisfy creditors, or to acknowledge debts and arrange for reduced payments, may indicate responsible behavior toward financial obligations -- especially if the subject has also changed to a more responsible lifestyle. Claims that past delinquent debts have been paid off need to be documented.

Credit Counseling

The National Foundation for Credit Counseling (NFCC), formerly the National Foundation for Consumer Credit, is a nonprofit organization whose purpose is to educate, counsel, and promote the wise use of credit. As of October 2003, it had 150 member services with 1,300 offices in the United States, Puerto Rico, and Canada. Most of these operate under the name Consumer Credit Counseling Service.

As of 2005, NFCC agencies provided free or low-cost services to an estimated 1.5 million families annually. More than 90% of the U.S. population has convenient access to one of the member offices.

People who seek credit counseling report various situations that have led them into financial hardship. The table below shows the reasons that NFCC clients gave for their financial problems in 2003. The average client described by this table was 39 years old, had almost $30,000 in debt, and had a debt-to-income ratio of 95.6%. In other words, their monthly debt payments were approaching the same amount as their monthly income. [25]

Reasons for Financial Problems

Poor Money Management	49.1%	Gambling	2.3%
Reduced Income/Unemployment	26.1%	Death of Family Member	.9%
Medical Bills, Accident/Disability	7.2%	Substance Abuse	.4%
Divorce/Separation	6.1%	Other or Not Classified	7.9%

It is interesting to note the number of cases in which the financial problems were caused by factors beyond the individual's control. A total of almost 40%

were caused by lost or reduced income, medical bills, or divorce/separation. In some of those cases, however, some type of undesirable behavior may have played a role in causing the unemployment, medical problem, or divorce/separation. The "poor money management" and "other" categories cover problems that were caused by immaturity, irresponsibility, and compulsive spending. They amounted to about 60% of all cases.

NFCC reports that about 29% of those counseled are able to help themselves after budget counseling sessions; 29% require a debt repayment program, 6% are referred to legal assistance, and 26% are referred to other resources (e.g., programs for treating compulsive behavior). In the debt repayment program, counseling services make arrangements with creditors to reschedule payments; the consumer then makes a single monthly payment to the counseling service, which in turn pays creditors according to the arranged plan. The most recent NFCC data show that debt repayment programs are successful in more than 90% of cases. 26

The NFCC recommends that consumers seek credit counseling when they are able to answer “Yes” to any of the following questions:

- Are you always late with bill payments?
- Would you find it impossible to pay for basic living expenses if you lost your job?
- Do you put off medical or dental visits because you can’t afford them?

When individuals who seek credit counseling are compared with those who do not, those who do receive counseling subsequently have a much higher loan repayment rate, have lower overall debt in the years following counseling, present more responsible spending patterns, and use credit less often and less frivolously. Data from a 2003 study of over 14,000 households counseled found that recidivism was low. Less than 10% continued to use credit unwisely and/or increased their overall debt in the three years following counseling. 27

Example - Mitigating a History of Debt

The subject of this example of how a history of debt might be mitigated is a 29-year-old unmarried male employed as a security officer. The adjudicator drafted a Statement of Reasons why continuation of subject’s Secret clearance was not clearly consistent with the national interest. The adjudicator found that financial irresponsibility resulted in excessive indebtedness and wage garnishments as follows:

- Automobile was repossessed four years ago with a remaining debt of $2,946, and subject made no attempt to satisfy this debt.
- Debt of $490 to Sears Roebuck, with last payment three years ago.

- Debt of $72 to the May Company, with no payment during past two years.
- Wages garnished by the State of California for unpaid income tax of $2,737 three years ago, and again for $646 two years ago.

The adjudicator's supervisor approved continuation of the clearance based on special circumstances that caused the debts, systematic efforts to satisfy creditors, favorable change in financial habits, and subject's favorable employment record and favorable references.

Subject's financial difficulties arose four to five years ago after his fiancée, with whom he was living, became disabled and unable to work. Subject became the sole support of her, her daughter, and himself. The problem was aggravated by the fact that the fiancée spent too much money, did not inform subject of her spending, and would not pay debts even when she was working. He fell behind in their payments and his financial problems arose.

Subject has broken up with the fiancée and no longer lives with her. He currently has no charge accounts and pays cash for the things he buys. With his current income and expenses, he has a surplus of about $75 per month.

His tax debt has been satisfied through garnishment of wages. Two other judgments for unpaid debts not listed in the Statement of Reasons have been paid. Subject paid the debt to Sears Roebuck (which was actually only $4) and to the May Company after these debts became a security clearance issue.

Subject had made regular payments on the automobile for three years before falling behind. Subject himself asked the bank to repossess the car as he could no longer make payments. After this debt became a security clearance issue, subject reached agreement with the bank collection office to pay $100 per month. By the time of the hearing examiner decision, he had made five monthly payments.

The supervisor found that subject has paid all debts except the car, which he is in process of paying, and that subject appears to have recovered financially and to have his legal and financial affairs in order.

Reference Materials

Basics of Bankruptcy

Bankruptcy is a legal procedure that relieves a debtor of responsibility for some or all debts. Bankruptcy is not always bad and is far more common than most people realize. During fiscal year 2004, more than 1.6 million American households filed for bankruptcy. This is up from about 900,000 in 1995. [10]

Many people experience financial problems through no fault of their own, and the Bankruptcy Reform Act of 1978 loosened the rules for the express purpose of making it easier for people to get a fresh start. However, the continuing significant increase in bankruptcy filings since then led Congress to enact tighter bankruptcy rules in 2005. This law, which went into effect in October 2005, makes it more difficult for people to have their debts erased. Some of the key changes in the law are discussed below.

It is important to understand the difference between discharge of a bankruptcy and dismissal of a bankruptcy, as these two similar words have opposite meanings.

- **Discharge** of a bankruptcy petition means the petition has been approved and the subject is no longer responsible for the debts specified in the petition.
- **Dismissal** of a bankruptcy petition means the bankruptcy court has rejected the petition or the debtor has withdrawn it. The individual is still responsible for his or her debts. Dismissal by the court may mean there has been some wrongdoing, such as fraud or failure to explain satisfactorily any loss or disappearance of assets that might be used to meet the debtor's liabilities. Or, it may mean that the debtor was unable or unwilling to comply with the terms of the bankruptcy.

Successful discharge of a bankruptcy petition does not necessarily wipe out all of a debtor's assets, nor does it necessarily eliminate all of the debts. A debtor's home is usually protected, as are income from Social Security benefits, unemployment benefits, veterans benefits, disability benefits, alimony, and child support to the extent that they are reasonably necessary for support of the debtor.

Some types of debts cannot be discharged through bankruptcy. These include certain tax liabilities; debts incurred by fraud, embezzlement, or larceny; alimony or child support; fines imposed by any government; student loans (unless not exempting them would cause "undue hardship"); debts from a credit spree just before filing for bankruptcy; damages from drunk driving; and any debt not included in the debtor's list of liabilities included in the bankruptcy petition.

The bankruptcy law is divided into chapters. The two principal ways for an individual to file for personal bankruptcy are Chapter 7 and Chapter 13. Chapter 12 is similar to Chapter 13 but limited to individuals operating a family farm. Chapter 11 applies only to corporations.

Chapter 7: This has been the most common type of bankruptcy and is sometimes referred to as straight bankruptcy or liquidation. The debtor may retain future earnings but loses all current assets except those declared exempt from the bankruptcy. Certain essential assets, as noted above, are normally exempt. All nonexempt assets are sold by a court-appointed trustee to pay off unsecured creditors as much as possible. All remaining unsecured debt such as credit card debt and personal loans is wiped out, but all secured debt such as mortgages must still be paid. A Chapter 7 filing usually remains on a credit report for ten years and cannot be repeated for six years.

In the past, more than two-thirds of all bankruptcy filings were made under Chapter 7. The 2005 bankruptcy act makes it more difficult to file for Chapter 7 and have all debts cancelled. Applicants are subject to a two-part means test to qualify for Chapter 7. First, individual or family income is compared with the state's median income for a family of the same size. If income is below the state median, an applicant is automatically qualified for Chapter 7. Second, if income is above the state median, a formula is applied to determine if the individual can afford to pay 25 percent of the "nonpriority unsecured debt" such as credit card bills. This formula looks at income over the past six months and then determines if the applicant can afford to pay at least $6,000 over five years, or $100 per month, toward the debt. An applicant who is able to pay $100 per month is ineligible for Chapter 7 and must file for Chapter 13. The expenses used in this calculation are not determined by your actual expenses, but by IRS rules that state what "reasonable" expenses are. 28

Chapter 13: Under the 2005 law, Chapter 13 is designed for individuals with regular income who can make some payment on the debts. It consolidates and restructures debts to repay creditors, in full or in part, in installments over a three to five year period. During this time creditors are limited in their collection efforts. The payments are supervised by a court-appointed trustee. Most remaining debts are canceled at the time the individual emerges from the bankruptcy proceeding except that, under the 2005 law, debtors must pay at least 25 percent of their credit card debt. The record of the Chapter 13 filing remains in one's credit report for seven years.

Under the old law, the court determined what a person could afford to pay based on what the individual and the court considered to be reasonable and necessary expenses. Under the 2005 law, there are strict limits on the amount that can be claimed as living expenses. The court applies the IRS National and Local Standard Expense guidelines to determine what are reasonable expenses and, therefore, how much money is available to pay off debts. Different standards apply depending upon income. The court may order that spending on luxury items, vacations, or extracurricular activities for children (sports, etc.) be eliminated or reduced. 28

Other Changes in 2005 Law: The 2005 law also makes many other changes. Among the most significant are:

- Lawyer Liability: If information about a client's case is found to be inaccurate, the bankruptcy attorney may be subject to various fees and fines. This means bankruptcy attorney fees will be higher because of the legal liability and more work required to verify a client's information.

- Mandatory Credit Counseling: At the time they apply or within the prior six months, bankruptcy applicants must receive at their own expense counseling and a budget analysis from an approved, nonprofit budget and credit counseling agency. After the bankruptcy is approved and before the debts are actually discharged, individuals most attend government-approved money management classes at their own expense.
- Protection from Eviction: The automatic stay for evictions has been eliminated. This means that if a landlord has already begun eviction proceedings, the renter must now either move out or pay the entire rent owed within 30 days.

Business Bankruptcies: Most business bankruptcies are actually personal bankruptcies under Chapter 7 or Chapter 13. This is because most businesses are either sole proprietorships or partnerships where the individual is personally liable for the business debts. Corporations file for bankruptcy under Chapter 11 of the bankruptcy code, which allows a business to reorganize as a going concern rather than be liquidated. It provides the business with breathing room to scale down its operations and work out a plan of repayment acceptable to its creditors.

Limitations of Credit Reports

The following forms of debt do *not* generally appear on the report: unpaid alimony unless there has been a court order to pay, federal and state tax delinquencies, automobile leases, gambling debts, personal loans, pawnbroker loans, and debts to doctors, dentists, hospitals, utility companies, and local stores unless they have been turned over to a collection agency. Delinquent federal student loans and child support payments now appear on credit reports as a result of stepped-up enforcement action. Types of debt that do regularly appear on a credit report are not always complete.

Credit scores, the most influential figure that determines whether a loan will be approved or not, are based on credit report information. If this information is incomplete, it can, and often does, lead to erroneous credit scoring. Credit scores have no "shelf life," because the information used to calculate them can change from day to day. Credit scores from each of the three major credit bureaus may be significantly different. This is because the credit bureaus collect data at different times of the month, and some creditors do not submit reports to all three bureaus. 29

Credit reports are now significantly more accurate than in years past. This is due, in part, to The Fair & Accurate Credit Transactions Act of 2003 that entitles all credit users to receive a free credit report from each major credit bureau once a year. This can be requested at https://www.annualcreditreport.com/cra/index.jsp

Glossary of Credit Abbreviations

30 DAY DEL -- Account past due 30 days

30 2 TIMES -- Account past due 30 days 2 times

30 6+TIMES -- Account past due 30 days 6 times or more

30 WAS 60 -- Account was delinquent 60 days, now 30 days

BAD DEBT -- Bad debt; placed for collection; written off to profit and loss

BK 7-FILE -- Voluntary or involuntary petition for Chapter 7 bankruptcy

BK 7-DISC -- Voluntary or involuntary petition in Chapter 7 bankruptcy discharged

BK 7-DISM -- Voluntary or involuntary petition in Chapter 7 bankruptcy dismissed

BK 11-FILE -- Voluntary or involuntary petition in Chapter 11 bankruptcy filed

BK 13-FILE -- Petition in Bankruptcy Chapter 13 filed

BK 13-COMP -- Petition in Bankruptcy Chapter 13 completed

BK ADJ PLN -- Debt included in or completed through Bankruptcy Chapter 13

BK DISC -- Bankruptcy discharged

BK LIQ REO -- Debt included in or discharged through Bankruptcy Chapter 7 or 11

CH 13 CASE -- Chapter 13 bankruptcy

CHARGE OFF -- Unpaid balance reported as a loss by credit grantor

CHATTEL MO -- Chattel mortgage

CIV JD SAT -- Civil judgment satisfied

CLOS INAC -- Closed inactive account

CLOS NP AA -- Credit line closed, not paying as agreed

COLL ACCT -- Account seriously past due; account assigned to attorney, collection agency or credit grantor's internal collection department

CO NOW PAY -- Now paying, was a charge-off

COUNSEL SER -- Debt counseling service

CO TAX LN -- County tax lien

CO TAX REL -- County tax lien released

CR CD LOST -- Credit card lost or stolen

CR LN CLOS -- Credit line closed, reason unknown or by consumer request; there may be a balance due

CR LN RNST -- Account now available for use and is in good standing. Was a closed account

CURR ACCT -- This is either an open or closed account in good standing

CUR WASCOL -- Current account was a collection account

CUR WAS DL -- Current account was past due

CUR WAS FOR -- Current account. Foreclosure was started.

CUR WAS 30 -- Current account was 30 days past due

CURWAS 30-2 -- Current account was 30 days past due twice

CURWAS 30-3 -- Current account was 30 days past due 3 times

CURWAS 30+6 -- Current account was 30 days past due 6 times or more

CUR WAS 180 -- Current account was 180 days or more delinquent

CV SUIT FI -- Civil suit filed

DECEASED -- Consumer deceased

DELINQ 60 -- Account delinquent 60 days

DELINQ 90 -- Account delinquent 90 days

DELINQ 180 -- Account delinquent 180 days

DEL WAS 90 -- Account was delinquent 90 days, now 30 or 60 days

DEL WAS 120 -- Account was delinquent 120 days, now 30, 60, or 90 days

DEFLT JDGMT -- Judgment by default

FED TAX LN -- Federal tax lien

FED TX REL -- Federal tax lien released

FIN COUNS -- Financial counselling

FIN DIVORCE -- Final divorce

FIN STMENT -- Financial statement

FORECLOSURE -- Credit grantor sold collateral to settle defaulted mortgage

FORE PROC -- Foreclosure proceeding started

GOV CLAIM -- Claim filed with government for insured portion of loan balance

INS CLAIM -- Claim filed for payment of insured portion of balance

JD DEFAULT -- Judgment by default

JUDJ RELEA -- Judgment released

JUDGMT SAT -- Judgment satisfied

JUDG VACAT -- Judgment vacated or reversed

MECH LIEN -- Mechanics lien

MECH RELE -- Mechanics lien released

NOT PD AA -- Account not being paid as agreed

NT RESPON -- Not responsible notice e.g., husband or wife claims not responsible for debts incurred by the spouse

OVER 30 -- Pays (or paid) in more than 30 days, but not more than 60 days,

1 PAST DUE -- Not more than 1 payment past due

OVER 90 -- Pays (or paid) in more than 90 days, but not more than

3 PAST DUE 120 days -- 3 or more payments past due

OVER 120 -- Pays (or paid) in 120 days or more

PD BY DLER -- Credit grantor paid by company who originally sold the goods

PD CHG OFF -- Paid account, was a charge-off

PD COLL AC -- Paid account, was a collection account, insurance claim or education claim

PD FORECLO -- Paid account. A foreclosure was started

PD NOT AA -- Paid account. Some payments were made past agreed due dates

PD REPO -- Paid account, was a repossession

PD WAS 30 -- Paid account, was past due 30 days

PD WAS 30-2 -- Paid account, was past due 30 days 2 or 3 times

PD WAS 30-4 -- Paid account, was past due 30 days 4 times

PD WAS 30+6 -- Paid account, was past due 30 days 6 times or more

PD WAS 180 -- Paid account, was delinquent 180 days or more

REMD REPO -- Account was a repossession, now redeemed

REPO -- Merchandise taken back by credit grantor; balance may be due

SCNL -- Credit grantor cannot locate consumer

SCNL NWLOC -- Credit grantor could not locate consumer, consumer now located

SETTLED -- Account legally paid in full for less than the full balance

SLOW PAY -- Not paying as agreed

STAT TX LN -- State tax lien

STA TX REL -- State tax lien released

SUIT DISMD -- Suit dismissed or discontinued

TOO NEW RT -- Too new to rate

TRANSFERRED -- Account transferred to another office

VOLUN REPO -- Voluntary repossession

WAGE ASIGN -- Wage assignment

WAGE EARNR -- Making payments under Wage Earner Account Plan (Chapter 13 bankruptcy)

W/A RELEASE -- Wage assignment released

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