

**BANKRUPTCY REFORM'S IMPACT:
WHERE ARE ALL THE "DEADBEATS"?**

*An Analysis by the
National Association of Consumer Bankruptcy Attorneys*

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EXECUTIVE SUMMARY

Contrary to the claims of proponents that all they intended to do is zero in on “deadbeats” crippling the U.S. economy with “billions of dollars in losses associated with profligate and abusive bankruptcy filings,” the sweeping federal bankruptcy law changes that went into effect on October 17, 2005 are doing little more than imposing new costs and paperwork burdens on tens of thousands of already distressed Americans, the vast majority of whom are being forced into bankruptcy due to financial circumstances beyond their control.

The following are key findings from a National Association of Consumer Bankruptcy Attorneys (NACBA) survey of six major credit counseling agencies that have dealt with a total of 61,335 consumers under the new federal bankruptcy law:

- ***As predicted by opponents of the legislation: Almost none of those seeking bankruptcy protection are able to repay their debts.*** Fewer than one out of 20 consumers (3.3 percent) were candidates for paying off what they owe under a debt management plan (DMP), with the remaining 96.7 percent requiring the same bankruptcy filing that they would have needed before the new bankruptcy law went into effect. And, many of the 3 percent who may have been candidates for a DMP based on income needed bankruptcy relief (often a chapter 13 payment plan) to forestall immediate harm, such as a home foreclosure that a DMP could not prevent. Thus, the credit counseling requirement under the new law, designed to steer debtors who could repay their debts into a debt management plan, simply imposes new costs and time burdens on individuals who can ill afford either – and clearly are not the people for whom a DMP is feasible.

- ***Also as predicted by opponents of the legislation: The vast majority of Americans seeking bankruptcy protection are victims of unfortunate circumstances, not imprudent spenders seeking to cancel their debts.*** Four out of five consumers (79 percent) seen by credit counseling agencies are suffering from debt “caused by circumstances beyond their control (e.g., loss of a job, medical expenses, death, divorce or other change in marital status, increased minimum payments on credit cards, predatory lending, and so on). Only about one in five of the respondents (21 percent) were identified as suffering from debt due to “circumstances within their control”. The credit counselors included in this group all of those individuals who did not deliberately seek to accumulate excessive debt and, instead, through creditor blandishments and lack of financial sophistication, “got in over their heads” as finance charges and other fees mounted over a period of years. Thus, the masses of expected deadbeats who were supposed to be identified under the new law and forced into debt management plans have not materialized.

BANKRUPTCY REFORM: WHAT WAS EXPECTED

The passage of sweeping bankruptcy reforms in 2005 was preceded by two different and diametrically opposed sets of public statements.

On one side were consumer groups and other advocates for debtors who warned that the new bankruptcy law would not work as intended. Instead, these experts warned that the new law would impose harsh new burdens on individuals who had been engulfed by such hurricane-like events beyond their control such as high medical bills, loss of employment, the death of a spouse, divorce, natural disasters and other catastrophic setbacks. The following statement was typical of what Congress heard over and over again prior to the passage of the bankruptcy legislation:

*"It [the bankruptcy bill] treats all families alike. **It assumes that everyone is in bankruptcy for the same reason—too much unnecessary spending.** A family driven to bankruptcy by the increased costs of caring for an elderly parent with Alzheimer's disease is treated the same as someone who maxed out his credit cards at a casino. A person who had a heart attack is treated the same as someone who had a spending spree at the shopping mall. A mother who works two jobs and who cannot manage the prescription drugs needed for a child with diabetes is treated the same as someone who charged a bunch of credit cards with only a vague intent to repay ... Based on the Harvard medical study and other research, **I think you will find that most debtors are filing for bankruptcy not because they had too many Rolex watches and Gameboys, but because they had no choice.** You have a choice. It's a choice that you're making for the American people. Adopt new bankruptcy legislation. Establish a means test that targets abuse. But do not enact a proposal written to address myth and mirage more than reality ... **Overwhelmingly, American families file for bankruptcy because they have been driven there — largely by medical and economic catastrophe — not because they want to go there.** Your legislation should respect that harsh reality and the families who face it."¹ (emphasis added)*

On the other side of the divide, proponents of the new bankruptcy law claimed that the reforms were both fair and targeted in such a way (e.g., mandatory credit counseling) to slow down individuals abusing the system. Typical of the public statements made by those in favor of “overhauling” the bankruptcy system were the following:

*“House Judiciary Committee Chairman F. James Sensenbrenner, Jr. (R-Wis.) stated, ‘The need for bankruptcy reform is long-overdue and crucial to our Nation’s economy and the well-being of our citizens. **Every day that goes by without these reforms, more abuse and fraud goes undetected.** Every abusive bankruptcy filing adversely affects hardworking Americans in the form of higher interest rates and increased costs for goods*

¹ Testimony of Elizabeth Warren, U.S. Senate Judiciary Committee, February 10, 2005, pages 4-5.

*and services. America's economy should not suffer any longer from the **billions of dollars in losses associated with profligate and abusive bankruptcy filings.***"² (emphasis added)

*"Rep. Rick Boucher (D-Va.) ... commented, 'Bankruptcy is becoming a first stop for some, rather than a last resort, as debtors treat bankruptcy as **merely another financial planning tool and file for bankruptcy for simple convenience.** These practices are permitted under the current bankruptcy law which **allows debtors to walk away from their debts regardless of whether they have the ability to pay any portion of what they owe.** The legislation which was approved by the House Judiciary Committee today restores personal responsibility to the bankruptcy system by creating **a fair, needs-based system** for bankruptcy filings.'"³ (emphasis added)*

*"It's time to promote responsible borrowing while also ensuring the safety net offered by bankruptcy. It was not intended to be a convenient financial planning tool where **deadbeats can get out of paying their debt scott-free** while honest Americans who play by the rules have to foot the bill,' Grassley said."⁴ (emphasis added)*

*"... our goal was to disallow people from filing bankruptcy simply for the sake of **taking advantage of a financial opportunity provided by the government.** People who can afford to pay all or a part of their debts over a limited period of time should not get off scot free."⁵ (emphasis added)*

² House Judiciary Committee News Release, "Committee Approves Senate-Passed Bankruptcy Reform Legislation Without Amendment," March 16, 2006, page 1.

³ Ibid.

⁴ Office of Senator Chuck Grassley, "GRASSLEY RENEWS EFFORT TO REFORM BANKRUPTCY CODE; Bill Includes Permanent Chapter 12 Protection for Farmers, New Consumer Protections, Child Support Provisions," February 2nd, 2005, page 1.

⁵ Senate Floor Statement of Senator Jeff Sessions, "BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005," March 10, 2005, page 1.

BANKRUPTCY REFORM: WHAT HAS ACTUALLY RESULTED

Who was right about the impact of the new bankruptcy law?

Four months have passed since the major changes to federal bankruptcy laws went into effect on October 17, 2005. In order to determine how the law has worked in practice, the National Association of Consumer Bankruptcy Attorneys sent a survey in February 2006 to 10 of the leading credit counseling firms authorized to provide the credit counseling required under the new law. Of this group, six credit counseling firms provided full responses to the following questions:

NACBA is interested in learning more about how the new (bankruptcy) law is working. As a credit counseling agency, you serve as an important gatekeeper to the process.

We have four very short/simple questions that we would like to ask you about your experiences under the new law. We are happy to deliver these questions verbally now, or in writing by email or by fax.

We hope to have your response to these questions by Friday, February 17th. We will be releasing the responses to the news media shortly thereafter in an effort to paint a picture of how the new law is working.

Questions:

1. How many debtors have you served since the new bankruptcy law took effect on October 17, 2005?
2. Of those, what percentage would you estimate qualified for a debt management plan, as opposed to filing for bankruptcy?
3. What percentage of people contacting you would you estimate arrive as referrals from bankruptcy attorneys?
4. Roughly what percentage of people contacting you would you say fall into the following categories:

** Circumstances beyond their control (e.g., loss of a job, medical expenses, death, divorce or other change in marital status, increased minimum payments on credit cards, predatory lending, and so on)?*

** Circumstances within their control (e.g., reckless spending or outright refusal to pay legitimate debts)?*

A total of 10 credit counseling firms were approached for survey purposes by NACBA. Of this group, a total of six responded -- Money Management International (Houston, TX), GreenPath Inc. (Farmington Hills, MI), Springboard Nonprofit Consumer Credit Management (Riverside, CA), Hummingbird (Raleigh, NC), Institute for Financial Literacy (Portland, ME) and ByDesign Financial Solutions (Los Angeles, CA). The aggregate findings of the NACBA survey were as follows:

Names of credit counseling organization	Number of consumers served	Qualifying for debt management plan (DMP)	Seeking protection due to circumstances beyond their control	Seeking protection due to circumstances within their control
Money Management International, Green Path Inc., Springboard Nonprofit Consumer Credit Management, Hummingbird, Institute for Financial Literacy, and ByDesign Financial Solutions	61,335 <i>(with responses ranging from a low of 100 to a high of 22,382)</i>	3.3 percent <i>(average for five with response ranging from a low of 1-2 percent and a high of 5 percent)</i>	79 percent <i>(average for five with responses ranging from a high of 95 percent to a low of 65 percent)</i>	21 percent <i>(average for five with responses, ranging from a low of 5 percent to a high of 35 percent)</i> <i>Note: Two firms reported anecdotally that this category may be too broad, since many consumers might have avoided debt but "got in over their heads" over a period of time without intending to do so.</i>

(This data will be supplemented as additional information is made available from other respondents to the NACBA survey.)

ABOUT NACBA

Established in 1992, the National Association of Consumer Bankruptcy Attorneys (<http://www.nacba.org>) is the only organization dedicated to serving the interests of consumer bankruptcy attorneys and protecting the rights of consumer debtors in need of bankruptcy relief. The Association's twin missions are to help consumer bankruptcy attorneys more effectively represent their clients and ensure that the voices of consumer debtors and their attorneys are heard in the halls of Congress, the Judiciary, and in other arenas where consumer debtors are affected.