Bankruptcy filings on rebound; Banks backed strict new law to reduce number

The Baltimore Sun

April 17, 2006 Monday

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Six months to the day after a sweeping new bankruptcy law was put in place to reduce the number of cases, consumer filings appear to have bottomed out and are again climbing, with some experts predicting the number of filers will return to previous levels in a year or so.

Additionally, pre-bankruptcy credit counseling — one of the more controversial requirements of the new law — appears to have little impact on steering people away from bankruptcy.

The law's critics say the rising numbers support their complaints that the new hurdles to bankruptcy will not significantly reduce filings because few people abuse the system.

Banking groups that pushed for the changes say they're encouraged by early results showing a sharp drop in filings since the new law kicked in Oct. 17.

But they say it's too early to judge the long-term effectiveness of the law.

And though cases are rising now, banking groups add, the figures are not at the level of recent years in which personal bankruptcies easily topped 1 million annually.

But with rising energy costs, increases in the minimum payments on credit card bills and the impact of higher interest rates on adjustable-rate and interest-only mortgages, it's just a matter of time before more consumers living on the edge are pushed into bankruptcy, lawyers and others said.

Stringent standard

Credit-card issuers lobbied hard for years for bankruptcy changes, claiming some filers were abusing the system and could repay their debt. The overhaul by Congress added new requirements for filers.

Filers at or below the median income for their state still can file under Chapter 7, where most debts are wiped out. But those above it must undergo means testing to determine whether they instead must file under Chapter 13, where some or all debts are repaid over five years.

Consumers also must receive credit counseling in the six months before filing, followed by a two-hour class on financial management before debts are discharged. And they can file under Chapter 7 every eight years, instead of six.

People rushed to file before more stringent measures took effect. Personal bankruptcies rose 30 percent last year to a record at more than 2 million. Nearly 500,000 of those were filed in the week leading up to Oct.17, said Chris Lundquist, president of Lundquist Consulting, which compiles bankruptcy data.

In the weeks after the law took effect, bankruptcies plummeted. Figures show they trickled to between 500 and 1,000 a day, down from the typical 6,000 cases, Lundquist said.

Still, he said, there is nothing in the numbers to indicate that filings will remain low. Cases dropped off because so many people had filed earlier. Filings are now increasing and have reached about 2,500 a day, Lundquist said.

Also, 60 percent of filings late last year were under Chapter 13, twice the usual percentage. In March, Chapter 13 cases fell below 40 percent of filings, with Chapter 7 filings making a comeback, Lundquist said.

The surge in last-minute filings was far greater than banks expected, and some ended up writing off hundreds of millions of dollars in uncollectible debt. Despite the hit, banking groups say they are optimistic that the new law will rein in filings, or at least get more filers who can afford to repay debt to do so.

”If the new law is making people take a closer look at bankruptcy, that’s not a bad thing. We were growing at such a high rate, it was just not sustainable,” said Laura Fisher, spokeswoman for the American Bankers Association.

The decline in filings “does suggest that there was a lot of discretionary filing, which was the key argument that we put forward,” said Fritz Elmendorf, a spokesman for the Consumer Bankers Association. “It’s often become something of a financial planning tool, and it’s not necessarily people at the very end of their ropes.”

But others say abuse is rare and consumers often wind up in bankruptcy after a crisis such as an illness, job loss or divorce.

Chief Judge Duncan W. Keir of the U.S. Bankruptcy Court in Baltimore said among the thousands of cases he has seen in his 12 years on the bankruptcy bench, only a handful appeared to be an attempt to abuse the system.

Critics say the new law succeeded only in raising hurdles to filing.

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Even with new obstacles, credit counselors and legal experts expect bankruptcy filings to return to their old levels.

”There is no other viable alternative. People have significant money problems,” Botes said.

Statisticians for the federal courts predict that filings will return to normal levels as early as the beginning of next year, said Mark D. Sammons, clerk of the bankruptcy court in Baltimore.

Baltimore lawyer Robert N. Grossbart expects a surge in Chapter 13 filings, which protect homes from foreclosures, once the impact of rising interest rates hits those with interest-only and adjustable-rate mortgages.

`A hard decision’

The prospect of losing her house caused Denyse Wright of Havre de Grace to file for bankruptcy recently.

”It was a hard decision to make. I thought about it for a very long time ... a good six months,” she said.

Wright said her husband’s hours at work had been cut back, and the couple helped out a son when he lost his job. On top of that, Wright had surgery last summer. When her mortgage lender threatened to foreclose, Wright said bankruptcy was her only recourse.

”We were at the point, `Will you have a place to live or not?’ “ she said.

Wright said filing under the new law isn’t difficult. “For people who make these decisions lightly, it’s almost too easy,” she said.

Like several others interviewed at a recent creditors’ meeting in Baltimore, Wright said the upfront credit counseling didn’t help. “It was stuff I already knew,” she said. “But I was past that point ... everything was so far behind.”

Many lawyers from the outset didn’t like the requirement that consumers undergo credit counseling to learn about alternatives to bankruptcy. Lawyers worried that counselors would talk consumers out of bankruptcy and into a debt management plan run by the counseling agency.

Few — if any — consumers decide against filing for bankruptcy after a counseling session, lawyers and credit counselors agree.

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”The majority we see for pre-filing counseling are in the beginning stages of foreclosure,” he said.

The average pre-filer carries about $90,000 in debt, including mortgage, and holds nine to 10 credit cards, Godfrey said. That’s about $30,000 more debt and a couple of extra cards than the usual counseling client, he said.

”We are seeing the vast majority — 95 or 98 percent — certainly do need to be filing for bankruptcy,” said Ivan L. Hand Jr., president of Money Management International, a credit counseling service based in Houston.

Hand said these consumers tend to wait just before filing to seek counseling, but credit counseling would be more effective, say, nine months earlier when there is still time to turn finances around.

Critics and advocates of the new law seem to agree that the required financial management classes that filers must take to get debts discharged have been useful.

”This is the first law that mandates adult financial literacy,” said Leslie E. Linfield, executive director of the Institute for Financial Literacy of Portland, Maine. “The concept of bankruptcy is a fresh start. ... We have to give them the tools of financial education to help them with that fresh start.”