

# **Consumer Credit Counseling**

## **Knowing Your Options A Briefing for Individuals Contemplating Bankruptcy**

### **Part 1 Overview**

**You are contemplating bankruptcy and probably have a number of questions.**

**Is bankruptcy the best option for you?**

**What types of bankruptcy are there?**

**What effect will bankruptcy have on you and your family?**

**Do you have other options?**

**What happens to your credit after bankruptcy?**

**Are all debts dischargeable during bankruptcy?**

The laws that govern bankruptcy changed a great deal in 2005. Information and advice you may have been given by a friend or relative is probably no longer accurate. When it comes to details regarding bankruptcy regulations, your specific questions are best answered by an attorney that practices bankruptcy.

This overview is designed to help you determine what options are available to you and help you determine which one best suits your needs.

The new changes to the bankruptcy law provide that bankruptcy is the option of last resort and that households whose incomes are above their state average must make substantial life-style adjustments to obtain bankruptcy relief.

### **What are the types of bankruptcy?**

Chapter 7 is also called a liquidation bankruptcy. In a Chapter 7 bankruptcy the assets that are not exempt from creditors are collected, sold, and the money is used to pay creditors. An eligible debtor may have his/her debts discharged with the exception of certain debts that are not eligible for discharge. Examples of debts that may not be dischargeable are child support, school loans and court ordered restitution.

Chapter 11: Reorganization bankruptcy is used primarily by businesses to reorganize their debts while continuing to operate.

Chapter 12: Family farm reorganization bankruptcy allows eligible family farmers to file for bankruptcy, reorganize the farm's business affairs, and continue to operate.

Chapter 13: A wage-earner's reorganization bankruptcy is used by individuals to reorganize their financial affairs in a plan. Individuals repay a portion of their debts in a period of time not to exceed five years.

### **What does my household income have to do with my filing bankruptcy?**

The new system has been made needs based. If you have the ability to repay part or all of your debt, you may be required to do so.

To qualify to file a Chapter 7 bankruptcy a number of factors are reviewed. Your attorney will conduct a means test. Your average income for the last six months will be compared with the average income in your state for a household your size. If you are under the state average (according to the US Census) you may be eligible to file for Chapter 7 bankruptcy. If you earn above the state average you will be directed to go through additional testing. If you are not eligible to file a Chapter 7 bankruptcy, you may be eligible to file a Chapter 13 bankruptcy where you repay a portion of your debt over the next 5 years. When you file for bankruptcy you will need to verify your income and will be asked for your recent tax return.

### **How does bankruptcy affect my credit report and credit score?**

The bankruptcy will be listed on your credit report. A bankruptcy does not wipe your credit report clean. If you had delinquencies or collections on your credit report, they will stay on your credit report; they are no longer collectible once they are discharged through a bankruptcy. Debts discharged through your bankruptcy should have a zero balance.

Account information for creditors in your bankruptcy will remain on your credit report for a maximum of 7 years from the date the bankruptcy was filed. The bankruptcy itself, listed in the public record section of the credit report will remain on 7 years from the date of filing for a Chapter 13 bankruptcy or 10 years from the filing date for a Chapter 7, 11, or 12 bankruptcy.

Your credit score is based on how you repay your debts. Often times a credit score will decline when you file bankruptcy. One study found the average credit score declined 80 points after a bankruptcy. Keep in mind your credit score may already be low since you have not been able to make your monthly payments as agreed.

### **Will I be able to get credit after filing bankruptcy?**

There are no clear cut answers here. Some lenders will not lend to you as you will be considered a high risk and they may have a policy not to lend to people who file bankruptcy. Some lenders may be willing to lend you money because you cannot file bankruptcy again for a number of years. If you receive credit, you will pay at an interest rate higher than someone who has good credit. Keep in mind, it will take time to rebuild your credit.

## **Are all debts dischargeable in a bankruptcy?**

Not all debts are dischargeable in a bankruptcy. You will still need to pay things like taxes, child support, student loans and more. You should seek legal advice on when a debt is or is not dischargeable.

## **What affect does bankruptcy have on my family and me?**

What type of bankruptcy you are eligible to file will determine whether you can wipe out most of your debts (Chapter 7) or repay a portion of your debts (Chapter 13). It is your total household income, that will be used to determine which form of bankruptcy you can qualify for. The assets (recreational vehicles, antiques, entertainment devices, etc.) you and your family are allowed and are not allowed to keep are regulated by law. If a Chapter 13 bankruptcy is your option, the budget - living expenses you and your family are allowed will be approved by the bankruptcy trustee.

## **Do I have to list all my assets in a bankruptcy?**

In the process of filing for bankruptcy you must be honest in reporting your income, assets and all the information you provide. Individuals who fail to disclose information regarding assets or income, or who provide fraudulent information can and will be prosecuted by law.

## **What other options do I have?**

When it comes to your finances you have five basic options:

- Do nothing.
- Develop your own repayment plan.
- Enroll in a Debt Management Program offered by a credit counseling agency.
- Debt settlement
- File for bankruptcy.

It depends on your individual circumstances as to whether or not these are good options for your particular situation.

## **What if I choose to do nothing?**

Doing nothing is normally the worst option. If you do nothing, your situation normally deteriorates. Rarely will your finances improve by doing nothing. If you don't make up past due home or car payments you risk losing your house or your car. If you don't make arrangements with your creditors to pay your debts you may find yourself in small claims court or with your wages garnished.

## **Try a self-administered repayment program.**

The first step you should take when encountering financial problems is to contact your creditors. Many have hardship programs. Through these programs your creditors may be willing to make special arrangements with you for a limited time. Before contacting your creditors you should review your income and expenses. As you make arrangements with your creditors, make sure you will be able to live up to the terms.

In developing a self administered repayment program it may be difficult to gain the cooperation of your creditors to reduce interest and fees that keep you from making progress. In that case you may want to consider credit counseling.

### **What is credit counseling?**

There are a number of organizations that offer credit counseling. You should choose a credit counseling agency that is non-profit and accredited by an independent accrediting organization. The organization should provide counseling, education and an optional debt management program. If the credit counseling organization spends only 20 minutes with you and tries to set you up on a repayment program that only pays for your credit cards and ignores your other debts, find another credit counseling agency to work with. The counselor should be a professional with some kind of certification and be able provide you advise on how to improve your overall financial situation.

A debt management plan, a debt consolidation plan without a loan, or a debt repayment program are basically the same kind of program.

### **What are the advantages and disadvantages of a debt management program?**

#### **Advantages:**

- With a Debt Management Program the credit counseling agency works with your creditors to reduce your payments and to lower your interest rates and reduce your fees.
- You make one payment to the credit counseling agency for the debt listed on the debt management program. The credit counseling agency forwards your payments to your various creditors enrolled in the program.
- The assets that you have are not limited when you enroll in a debt management program (DMP) as they are if you file bankruptcy.
- A DMP will not stop you from filing for bankruptcy at a later date. If you file bankruptcy and it is dismissed, this may affect your ability to file bankruptcy in the future.
- Some creditors will re-age your account after you make three consecutive monthly payments. If you are past due, your credit report will show that you are past due. When the creditor re-ages your account, payments you make after that point will not show as past due.
- Your actual expenses for necessities such as housing, utilities, and transportation are budgeted in your plan. Depending on the type of bankruptcy you qualify for, your actual expenses may be over the amount allowed by law.

## **Disadvantages:**

- You need to have money each month to pay your creditors. You do not get to determine this amount. A formula is used to determine what your monthly payment will be. Your repayment time will be 60 months or less.
- You cannot keep a credit card. You will have to agree not to use credit while on the program. In a Debt Management Program creditors are agreeing to accept reduced payments and make concessions on fees and interest. Creditors will do this provided you do not incur new debt.
- If you do not make your monthly payment you will be dropped from the debt management program. Your debts will still be owed to your creditors.
- There is no guarantee that a debt management program will stop a wage garnishment if you currently have your wages garnished. Cooperation by creditors in a debt management program is voluntary.

## **What is debt settlement?**

There are organizations called debt settlement companies that will offer to negotiate with your creditors. They will negotiate to pay only a portion of your debt and creditors write off the balance. This is an arrangement you should enter into very carefully. You may be able to negotiate a settlement directly with your creditors, you do not need a debt settlement firm to do this for you.

### **Advantages of Debt Settlement**

- You do not pay the full amount of your debt owing.

### **Disadvantages of Debt Settlement:**

- You will incur tax consequences for the amount of debt your creditors write-off. As an example, if your creditors write-off or forgive \$5,000 in debt, you will be required to claim that as income on your taxes even though you did not receive it as income.
- You need the ability to make large payments or settlements on your accounts. If not, you will need to save up until you can make a large payment. For most individuals, to do this they don't pay their other creditors. By not making your monthly payments you further hurt or adversely affect your credit.
- A write-off is not viewed positively on your credit report and can negatively impact your credit score.
- You will pay a fee for this service if you hire a debt settlement company to negotiate for you.

## **Part 2 Analysis**

### **Determining the Cause**

What do you believe is the major cause of your financial problems? Please fill out the attached form. Don't confuse causes with results. Having a car repossessed would be a result. What caused you not to make your car payment resulting in repossession? Was it that you were unemployed or perhaps you were in the hospital due to a medical condition? Having high credit card debt is a result. Having high credit card debt due to a gambling problem or being a shopaholic is the cause.

### **Filling out the Form**

Filling out the attached/enclosed budget will help you determine which option is best for you and your family.

What is your income from all sources? Be sure to include all household income.

What are your living expenses? Be sure to include expenses for everyone in the household.

What are your debts? List your debts individually.

### **Reviewing Your Income and Expenses**

Since you are contemplating bankruptcy it is likely that your expenses exceed your income. Have you explored all of your options to bring your income and expenses into an equal position?

Can you cut some of your living expenses to come up with enough money to pay your debts? Do you spend money on the following items that you could cut? Cable television, membership at a gym, cell phones, breakfast lunch or dinner out, hobbies, magazines, newspapers, gifts, etc.?

Can you refinance any of your current payments to reduce your payments or pay-off other debts? Perhaps you have a car that will be paid off in a couple months and is worth a few thousand dollars. Will your lender let you refinance your car and borrow against the car to pay off other debts? Do not take this as a suggestion to borrow against your car with a title loan company. Title loan companies are predatory lenders that charge high rates of interest and fees.

Do you have assets you can sell and use the money to pay-down or pay –off debts? Keep in mind the amount of assets you are allowed to keep through bankruptcy are limited. You may be forced to sell some assets before being able to file for bankruptcy. If you choose to file bankruptcy don't expect to keep items you own such as: a boat, snowmobile, 4-wheeler, motorcycle, or extra cars.

If you are buying your home, is it worth more than you owe on it? If you qualified for a home equity loan and used the money to pay-off some of your debts, would you then be able to handle your monthly expenses? This is something you need to consider carefully. It is most important that you still be able to make your house payment and your home equity payment. If you are unable to make these payments you risk losing your home even if you make your house payment. Not making a home equity payment puts your home in jeopardy.

Do you have a retirement account you can borrow against? If so, make sure you understand the repayment terms required for borrowing the money and whether or not you are subject to penalties, fees, and taxes.

Call your creditors and ask if they have any hardship program you could participate in that would reduce your monthly payment and the interest rate you are paying?

Can you or one of your family members get a part-time job?

If you are a young couple with expensive daycare, can you and your spouse work opposite shifts reducing the need for daycare?

If you have children, are they of working age where they can find a job to help cover some of their own expenses such as clothing, gasoline, car insurance, etc.?

Do you have other adults living in your household that are not contributing to the family budget? Now is the time to get them to help out.

Do you qualify for public assistance? Assistance for food, utilities, and housing may be available to you depending on your income and the programs offered by your state.

### **Part 3**

#### **Choosing Your Plan of Action**

Take action. Remember doing nothing only compounds your problems.

Review your income. Determine if there are ways available to you to increase your income.

Review your expenses. Make changes that will reduce your expenses.

Determine if you have monies available to repay your creditors or if filing for bankruptcy is your option.

Review the advantages and disadvantages of the option you are interested in and take steps to move forward.

If bankruptcy is your plan of action your attorney will need documents from you.

For all individuals and families:

- Pay stubs for the last 12 months.
- Any other verification of any other income for the last 12 months.
- Tax returns and w-2's for the last 4 years.
- Copies of contracts: house, cars, contract for deed, etc.
- Copy of separation agreement and property settlements
- Copy of divorce decree
- Retirement/Pension information: 401K statements, pension statements, life insurance statements

For individuals and families whose income is above the average for the state, 12 months of documentation are needed for the following:

Medical and prescription expense  
Food/grocery expense  
Day care expenses  
Charitable expenses

Clothing expense  
School expenses  
Home repair expenses

Updated 3-13-08