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*Financial Counseling under the Bankruptcy Abuse  
Prevention and Consumer Protection Act of 2005*

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**Abstract.** Section 106 of P.L. 109-8, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), creates credit counseling requirements for consumers seeking to file for bankruptcy under chapter 7 (governing the liquidation of a debtor's assets) and chapter 13 (governing the financial reorganization of a debtor's assets). In certain circumstances, these requirements may be waived. BAPCPA amends the U.S. Bankruptcy Code, 11 U.S.C. 109, to require an individual to receive credit counseling before filing a petition for bankruptcy. BAPCPA also amends the Bankruptcy Code to deny a discharge to chapter 7 and chapter 13 debtors who fail to complete a personal financial management instructional course. Both credit counseling agencies and personal financial management instructional course providers must obtain approval from a U.S. trustee before offering a course to satisfy these requirements. Section 106 of BAPCPA also creates a new provision which specifies the approval requirements for both credit counseling agencies and personal financial management instructional courses.

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# CRS Report for Congress

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## Financial Counseling under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

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### Summary

Section 106 of P.L. 109-8, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), creates credit counseling requirements for consumers seeking to file for bankruptcy under chapter 7 (governing the liquidation of a debtor's assets) and chapter 13 (governing the financial reorganization of a debtor's assets). In certain circumstances, these requirements may be waived. BAPCPA amends the U.S. Bankruptcy Code, 11 U.S.C. §109, to require an individual to receive credit counseling before filing a petition for bankruptcy. BAPCPA also amends the Bankruptcy Code to deny a discharge to chapter 7 and chapter 13 debtors who fail to complete a personal financial management instructional course. Both credit counseling agencies and personal financial management instructional course providers must obtain approval from a U.S. trustee before offering a course to satisfy these requirements. Section 106 of BAPCPA also creates a new provision which specifies the approval requirements for both credit counseling agencies and personal financial management instructional courses.

In April 2005, President Bush signed P.L. 109-8, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The purpose of the BAPCPA is not only to “improve bankruptcy law and practice by restoring personal responsibility and integrity to the bankruptcy system,” but to ensure fairness of the system for both debtors and creditors.<sup>1</sup> BAPCPA consists of a comprehensive package of reform measures pertaining to both consumer and business bankruptcy cases. One of its many amendments requires debtors to participate in credit counseling programs before filing for bankruptcy relief. BAPCPA's credit counseling provisions are intended to give consumers in financial distress an opportunity to learn about the consequences of bankruptcy, such as

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<sup>1</sup> H.Rept. 109-31, p. 2.

the potentially devastating effect it can have on their credit rating.<sup>2</sup> BAPCPA also requires debtors, after they file for bankruptcy relief, to receive personal financial management training. This training is intended to provide debtors with guidance about how to manage their finances in order to avoid future financial difficulties.<sup>3</sup>

***Credit Counseling and Bankruptcy — Overview.*** Section 106 of BAPCPA adds credit counseling as a prerequisite to Chapter 7 or Chapter 13 bankruptcy filing or relief.<sup>4</sup> Section 106(a) of BAPCPA amends section 109 of the Bankruptcy Code to require an individual to receive credit counseling within the 180-day period preceding the date of filing a petition for bankruptcy. The credit counseling must be provided by an approved “nonprofit budget and credit counseling agency”<sup>5</sup> and must consist of either an individual or group briefing.<sup>6</sup> This briefing, which may be conducted telephonically or via the Internet, must outline the opportunities for credit counseling and must assist the debtor in performing a budget analysis.<sup>7</sup>

A debtor may be exempt from the mandatory credit counseling requirement under section 106(a) in certain circumstances. The requirement does not apply to a debtor who resides in a district where the U.S. trustee has determined that approved credit counseling agencies in that district are not reasonably able to provide adequate services to such individuals.<sup>8</sup> A debtor may also be temporarily exempted from the mandatory credit counseling requirement if the debtor submits to the court a certification that: (1) describes exigent circumstances meriting a waiver of this requirement; (2) states that the debtor requested credit counseling services from an approved credit counseling agency, but was unable to obtain such services within the five-day period beginning on the date the debtor made the request; and (3) is satisfactory to the court.<sup>9</sup> This exemption terminates when the debtor meets the requirements for credit counseling participation, but not longer than 30 days after the case is filed, unless the court, for cause, extends this period up to an additional 15 days.<sup>10</sup>

In addition, a debtor may be exempt from the mandatory credit counseling requirement if the court determines, after notice and a hearing, that the debtor is unable to complete this requirement because of incapacity, disability, or active military duty in

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<sup>2</sup> H.Rept. 109-31, p. 18.

<sup>3</sup> Id.

<sup>4</sup> 11 U.S.C. § 101 et seq.

<sup>5</sup> Hereinafter referred to as “credit counseling agency.”

<sup>6</sup> H.Rept. 109-31, p. 54.

<sup>7</sup> Id.

<sup>8</sup> Id. The U.S. trustee is appointed by the U.S. Attorney General and is authorized to supervise the administration of chapter 7 and 13 bankruptcy cases. See 28 U.S.C.A. §581; 28 U.S.C.A. §586(a)(3). Some states allow for a “bankruptcy administrator” to perform this role, and this is acceptable under BAPCPA.

<sup>9</sup> H.Rept. 109-31, pp. 54-55.

<sup>10</sup> H.Rept. 109-31, p. 55.

a military combat zone.<sup>11</sup> Incapacity, under this provision, means the debtor is “impaired by reason of mental illness or mental deficiency so that the debtor is incapable of realizing and making rational decisions with respect to financial responsibilities.”<sup>12</sup> Disability under the 11 U.S.C. § 109(h) provision means that “the debtor is so physically impaired as to be unable, after reasonable effort, to receive credit counseling whether by participating in person, or via telephone or Internet briefing.”<sup>13</sup>

BAPCPA also amends the Bankruptcy Code to deny a discharge to chapter 7 and chapter 13 debtors who fail to complete a personal financial management instructional course.<sup>14</sup> This requirement does not apply if the debtor resides in a district where the U.S. trustee has determined that the approved instructional courses in that district are not adequate.<sup>15</sup> Such determination must be reviewed annually by the U.S. trustee.<sup>16</sup> In addition, these provisions do not apply to a debtor whom the court determines, after notice and a hearing, is unable to complete this requirement because of incapacity, disability, or active military duty in a military combat zone.<sup>17</sup> Section 106(e) adds section 111 to the Bankruptcy Code. Under section 111(a), the clerk<sup>18</sup> is required to maintain a publicly available list of approved credit counseling agencies and personal financial management instructional courses. Section 111(b) discusses the determinations that must be made by a U.S. trustee before a credit counseling agency or a personal financial management course can be approved.

Under section 111(b)(1), the U.S. trustee must undertake a thorough review of the qualifications of the credit counseling agency or personal financial management instructional course to ensure that the counseling services or course meets the standards set forth in section 111. The section also allows a U.S. trustee to require that the credit counseling agency or course provider provide information with respect to this review. If, prior to approval by the U.S. trustee, a credit counseling agency or instructional course did not appear on the list required under section 111(a), then approval shall be allowed for a probationary period not to exceed 6 months.<sup>19</sup> A U.S. trustee may grant subsequent approvals for successive 1-year periods thereafter if the counseling agency or instructional course has met the requirements under section 111 for the preceding period and can satisfy these standards in the future.<sup>20</sup>

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<sup>11</sup> 11 U.S.C. § 109(h)(4).

<sup>12</sup> 11 U.S.C. § 109(h)(4).

<sup>13</sup> *Id.*

<sup>14</sup> 11 U.S.C. § 106(b).; 11 U.S.C. § 106(c).

<sup>15</sup> 15 U.S.C. §728(a)(11); 11 U.S.C. § 1328(g)(2).

<sup>16</sup> H.Rept. 109-31, p. 55.

<sup>17</sup> *Id.*

<sup>18</sup> Presumably, “clerk” as referred to in section 106(e) is the clerk of the Bankruptcy Court.

<sup>19</sup> 11 U.S.C. § 111(b)(3).

<sup>20</sup> 11 U.S.C. § 111(b)(4), 11U.S.C. § 111 (b)(5).

**Approval Requirements for a Credit Counseling Agency.** New section 111(c) provides the minimum requirements for approval of a credit counseling agency. Under this section, a U.S. trustee shall only approve an agency that demonstrates that it will provide qualified counselors, maintain adequate provision for safekeeping and payment of client funds, provide adequate counseling with respect to client credit problems, and deal responsibly and effectively with other matters relating to the quality, effectiveness, and financial security of the services it provides.<sup>21</sup> Section 111(c)(2) elaborates on these requirements. In order for a credit counseling agency to be approved, the agency must:

- Have a Board of Directors the majority of which are not employed by the counseling agency and will not benefit directly or indirectly from the outcome of the counseling services;<sup>22</sup>
- Charge only a “reasonable” fee for counseling services, if the agency is to charge a fee. The counseling agency must also provide services regardless of the ability to pay the fee;<sup>23</sup>
- Provide for the safekeeping and payment of client funds, including an annual audit of the trust accounts and employee bonding;<sup>24</sup>
- Provide full disclosure to a client, including funding sources, counselor qualifications, possible impact on credit reports, and any costs of such program to be paid by the client and how such costs will be paid;<sup>25</sup>
- Provide adequate counseling with respect to a client’s credit problems that includes an analysis of such client’s current financial condition, factors that caused such financial condition, and how such client can develop a plan to respond to the problems without incurring negative amortization of debt;<sup>26</sup>
- Provide trained counselors who receive no commissions or bonuses based on the outcome of the counseling services provided by such agency, and who have adequate experience, and have been adequately

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<sup>21</sup> 11 U.S.C. § 111(c)(1).

<sup>22</sup> 11 U.S.C. § 111(c)(2)(A).

<sup>23</sup> 11 U.S.C. § 111(c)(2)(B). BAPCPA does not define the “reasonable” standard, however, it has been suggested that the U.S. Trustee would be in a position to define what constitutes a reasonable fee. See Leslie E. Linfield, *Strange Bedfellows: Bankruptcy Reform and Mandatory Credit Counseling*, 24-4 Am. Bankr. J. 12.

<sup>24</sup> 11 U.S.C. § §111(C)(2)(C).

<sup>25</sup> 25 11 U.S.C. § 111(c)(2)(D).

<sup>26</sup> 11 U.S.C. § 111(c)(2)(E).

trained to provide counseling services to individuals in financial difficulty;<sup>27</sup>

- Demonstrate adequate experience and background in providing credit counseling;<sup>28</sup>
- Have adequate financial resources to provide continuing support services for budgeting plans over the life of any repayment plan.<sup>29</sup>

Under section 111(e), a district court may at any time investigate the qualifications of a credit counseling agency and request documents to ensure the integrity and effectiveness of the agency. If the credit counseling agency does not meet the requirements as set forth in section 111, the district court may remove the agency from the section 111(a) approved list. A credit counseling agency is also prohibited from providing information to a credit reporting agency concerning whether a debtor has received or sought instruction on personal financial management.<sup>30</sup>

***Approval Requirements for a Personal Financial Instructional Management Course.*** Section 111(d) lists the requirements for approval by the U.S. trustee for a personal financial management instructional course.<sup>31</sup> During the initial 6 month probationary period discussed under section 111(b)(3), an instructional course must provide, at a minimum:

- Trained personnel with adequate experience and training in providing effective instruction and services;<sup>32</sup>
- Learning materials and teaching methodologies designed to assist debtors in understanding personal financial management and that are consistent with stated objectives directly related to the goals of such instructional course;<sup>33</sup>

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<sup>27</sup> 11 U.S.C. § 111(c)(2)(F).

<sup>28</sup> 11 U.S.C. § 111(c)(2)(G).

<sup>29</sup> 11 U.S.C. § 111(c)(2)(H).

<sup>30</sup> 11 U.S.C. § 111(g)(1).

<sup>31</sup> Requirements for the personal management instructional course are to be developed in a test program, discussed in 11 U.S.C. § 105 (2005). Section 105 provides, among other things, that the Director of the Executive Office for United States Trustees must (1) consult with a wide range of debtor education experts who operate financial management education programs; and (2) develop a financial management training curriculum and materials that can be used to teach individual debtors how to manage their finances better. The Director must select six judicial districts to test the effectiveness of the financial management training curriculum and materials for an 18-month period beginning not later than 270 days after the Act's enactment date. See 11 U.S.C. § 105.

<sup>32</sup> 11 U.S.C. § 111(d)(1)(A).

<sup>33</sup> 11 U.S.C. § 111(d)(1)(B).

- Adequate facilities situated in reasonably convenient locations at which such instructional course is offered, except that such facilities may include the provision of such instructional course by telephone or through the Internet, if such instructional course is effective;<sup>34</sup>
- The preparation and retention of reasonable records (which shall include the debtor's bankruptcy case number) to permit evaluation of the effectiveness of such instructional course, including any evaluation of satisfaction of instructional course requirements for each debtor attending such instructional course, which shall be available for inspection and evaluation by the Executive Office for United States Trustees, the United States trustee, or the chief bankruptcy judge for the district in which such instructional course is offered;<sup>35</sup>
- If a fee is charged for the instructional course, charge a reasonable fee, and provide services without regard to ability to pay the fee.<sup>36</sup>

There are additional requirements necessary for approval of a personal financial management course during any one year period following the initial probationary period. An instructional course provider must demonstrate that the course has satisfied the requirements of section 111(d)(1).<sup>37</sup> Also, under section 111(d)(2), an instructional course provider must demonstrate that the course has been effective in assisting a substantial number of debtors to understand personal financial management and that the course is otherwise likely to increase substantially the debtor's understanding of personal financial management.

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<sup>34</sup> 11 U.S.C. § 111(d)(1)(C).

<sup>35</sup> 11 U.S.C. § 111(d)(1)(D).

<sup>36</sup> 11 U.S.C. § 111(d)(1)(E).

<sup>37</sup> 11 U.S.C. § 111(d)(2).