NET GAIN | Scoring points for your financial future

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Getting out from under debt

Consider your options before diving into bankruptcy

By Christine Dugas
USA TODAY

Even if you've never been swamped by debt, odds are you know someone one who has.

Last year, a record 1.6 million households sought protection from creditors in bankruptcy. Over the past five years, personal bankruptcy filings totaled 7.1 million – or 7% of all U.S. households.

It's no wonder families are having financial problems. They are staggering under an estimated $1.7 trillion in debt, not including mortgages and home equity loans – a 32% increase since 1998.

As common as personal bankruptcy has become, however, few consumers know much about the system. Instead of taking time to consider their options, debt-stressed families often turn for help to the lawyer or credit-counseling agency with the biggest ads. "Many people in real financial distress put off dealing with their problems and then panic," says Travis Plunkett at the Consumer Federation of America (CFA).

If you are struggling to make ends meet, it's important to explore all your options and find out where you can go for good advice.

If you are not behind on your bills but are treading water by making minimum payments on credit card bills, you might be a good candidate for a credit education course or budget counseling. Many non-profit credit-counseling agencies offer such help.

You may be unaware how close to the edge you are living. One warning sign is if your total debt payments, excluding your mortgage and car, are between one-quarter and one-half of your after-tax income. If you're in that category, you should look for ways to lower your debt load even if you are current on your bills.

If you are routinely late paying bills, already behind on some of them or in danger of losing your home, you may need more immediate help restructuring your debts. In some cases, bankruptcy may be your best option. But how can you find out?

Seeking advice

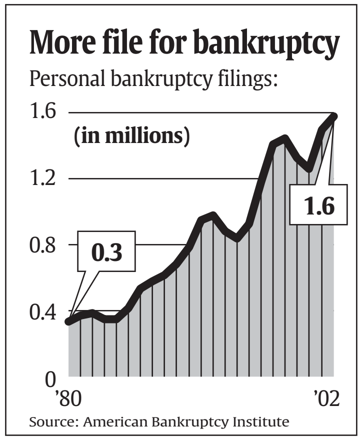
"It's very difficult to find totally objective advice," Plunkett says.

Two of the most common sources for help are credit-counseling agencies and bankruptcy lawyers. Credit-counseling agencies may favor their own debt-management plans and be reluctant to recommend bankruptcy, experts say. That's because they typically receive their funding from credit card issuers, and most credit card debt gets wiped out in bankruptcy.

Bankruptcy lawyers, on the other hand, may have a tendency to recommend filing for bankruptcy over other solutions because that's how they make their living. Low-income families can get impartial advice from local legal aid offices, though they don't usually handle bankruptcy filings, notes Henry Sommer, a supervising attorney at the Consumer Bankruptcy Assistance Project in Philadelphia.

That doesn't mean you can't get sound advice from a credit counselor or bankruptcy lawyer. Just be aware of potential biases and ask good questions. You may want to consult both and compare. Never let someone pressure you into making a decision.

There are other sources of information to help you assess your options. Nolo Press, which publishes self-help books about bankruptcy, also provides basic information about the topic at its Web site, www.nolo.com. The CFA recently co-authored a report on credit counseling, which includes advice for consumers. It's available at www.consumerfed.org.



By Julie Snider, USA TODAY

No cure-all

Anyone contemplating personal bankruptcy needs to understand that there are two types – Chapter 7 and Chapter 13 – and neither is a cure-all. "Bankruptcy doesn't solve your problems if your expenses are higher than your income," Sommer says. "It can provide temporary relief. But you need to bring the two into line."

Many consumers consider bankruptcy a sign of failure and prefer to try an "out-of-court" reorganization, such as a debt-management plan offered by credit-counseling agencies. Yet the suitability of each option depends on your circumstances. Regardless of your choice, you need to know that some debts, such as child support payments, can't be erased. (See box.)

Some basic information on your options:

▶ **Debt-management plans.** Credit card issuers often agree to lower interest rates or waive fees for consumers who participate in a debt-management plan (DMP) offered by a non-profit credit-counseling agency. The plan can help you resolve debt problems without resorting to bankruptcy. It also helps creditors get back much of what's owed them. The fact that you enter into a plan may show up on your credit report, but it won't be viewed as negatively as a bankruptcy.

A DMP usually takes into account only unsecured debt – typically, credit card bills. So it may not help if you're behind on your mortgage. You could end up paying off credit card bills at the expense of your home.

DMPs sometimes have other shortcomings, the CFA points out. For example, some credit-counseling agencies charge high fees. Others have deals with only some credit card issuers, so the DMP is only a partial solution. And credit card issuers have become less generous with concessions they offer to DMP participants, causing many consumers to drop out and file for bankruptcy.

▶ **Liquidation.** Chapter 7 liquidation is the most common type of personal bankruptcy. It erases most unsecured debts. But you must give up "non-exempt" property, which is sold to pay creditors.

You will be able to keep a certain amount of cash and equity in a home, as well as some household items, such as clothing and furnishings, according to your state's exemptions.

In some states, such as New York, you'll be limited to $10,000 in home equity. That means if you have more than $10,000 of equity in your home, it would have to be sold and anything in excess of that amount would go to creditors. A handful of states with unlimited homestead exemptions have been criticized for letting wealthy debtors shield assets from their creditors.

The filing fee for Chapter 7 bankruptcy is $200. It cannot be waived, Sommer says. Legal fees will run about $700 to $800, he says, depending on where you live and how complex your case is.

Non-dischargeable debts

Unless an exception applies, these are among the debts that you can't get rid of in bankruptcy:

▶ Student loans.
▶ Most federal, state and local taxes and money borrowed or charged on a credit card to pay those taxes.
▶ Child support, alimony and other support.
▶ Fines or restitution imposed in a criminal proceeding.
▶ Court fees for filing motions or appeals.
▶ Debts resulting from driving while intoxicated.
▶ Certain condominium and cooperative fees.

Source: *How to File for Chapter 7 Bankruptcy*, Nolo Press

Once you file for bankruptcy, you get immediate relief. Bill collectors have to back off. A landlord can't evict you, and the utility company can't turn off your electricity. "For some people, that's enough of a reason to file," says Stephen Elias, a co-author of Nolo Press's How to File for Chapter 7 Bankruptcy.

▶ **Reorganization**. Chapter 13 bankruptcy is called a reorganization. Debtors get to keep their property, so it's a way for families who have built up more equity in their home than their state exemption allows to save it from foreclosure.

But to be eligible for Chapter 13, debtors must have regular income. And they must be able to come up with a viable three- to five-year plan for repaying most debts. In a typical plan, you make monthly payments to a court-appointed trustee, who distributes the money to your creditors.

Most debtors never complete a Chapter 13 plan, experts say. It requires a lot of discipline. An unexpected expense can easily derail the plan. If that happens, a debtor can convert to a Chapter 7 bankruptcy.

After the storm

A bankruptcy filing can stay on your credit report for up to 10 years. Some lenders may be reluctant to extend new credit until some years after a bankruptcy, so they can see that you have a history of paying bills on time.

But it's become more common for lenders to offer credit cards immediately after a bankruptcy discharge, Sommer says. You may even be able to get a mortgage two to three years after a bankruptcy, though lenders might demand a higher interest rate

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It is illegal for employers to fire you simply because you have filed for bankruptcy. But if you are applying for a job, an employer may take into account your credit history when deciding whether to hire you. And a landlord might refuse to rent you an apartment.

Getting out from under debt

Objectives:

Students will:

- read the article, "Getting out from under debt."
- participate in large or small group discussion of the article.
- complete a graphic organizer.

Concepts:

- Bankruptcy
- Retirement risk
- Cause and effect
- Credit counseling
- Problem solving

Preparation:

- Give each student a copy of the article, "Getting out from under debt."
- Divide students into small groups or facilitate a large group discussion.
- Have students complete the graphic organizer, "Chain of events set off by job loss eventually resulting in bankruptcy" on their own.

Activity at a glance:

- Grade level: 9-12
- Subjects: economics, personal finance, credit counseling, retirement, bankruptcy
- Estimated time for this activity: 45-60 minutes

Materials:

- Reading: "Getting out from under debt"
- Copy of discussion questions and activity
- Graphic organizer

Getting out from under debt

Discussion:

According to the article, who should consider taking credit education or budgeting courses? What are the signs of an imminent financial crisis? What sources can individuals consult for sound, non-biased financial advice? What are the differences between Chapter 7 and Chapter 13 bankruptcy? Why do most debtors have difficulty completing the latter plan? Why is neither option a cure-all? What are the benefits and drawbacks of debt-management plans? How could filing for bankruptcy affect your professional and financial future?

Activity:

When an employee loses his or her job, he or she often loses more than a steady paycheck. Other repercussions can include the loss of health and life insurance and the cessation of retirement benefits. (While an employee won't lose what has been put into a retirement account, he or she can no longer contribute to it, and may even be forced to draw from it prematurely.) Consider the chain of events set off by the loss of a job. For example: termination; loss of wages; inability to pay bills; overuse of credit; mounting debt; etc. Then, complete the graphic organizer on the following page.

Additional resource:

- Goodpayer.com offers a handbook entitled "Learn Now or Pay Later" that helps young adults understand the basics of credit and debt. Visit www.goodpayer.com. You will see the booklet available in PDF format. To order a copy, call 800-756-4912.

Activity extensions:

- The decision to file for bankruptcy or restructure your debt is not an easy one and usually requires some outside assistance. Use the Internet to research sources for both credit counseling and filing for bankruptcy. Make a list of the options you find and also the pros and cons of filing for bankruptcy vs. restructuring your debt.

- List actions you could take in the event of a job loss to 1.) avoid spiraling debt and 2.) prevent bankruptcy. How will the decisions you make today determine how you manage your money in the future?

Chain of events set off by job loss eventually resulting in bankruptcy
1. Loss of job
2.
3.
4.
5.
6.
7.
8.
9.
10. Bankruptcy