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Does bankruptcy counseling help debtors establish a fresh start?

URBANA – With a struggling U.S. economy and a large number of employers downsizing their operations, many Americans are finding themselves in severe financial distress. In some cases, individuals decide their only solution is to file for bankruptcy. The American Bankruptcy Institute reported 1.4 million consumer bankruptcy filings in 2009 and a 17.5 percent increase in the number of bankruptcy cases filed the first three months of 2010 compared to a year ago.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was passed to assist consumers with making educated decisions regarding filing for bankruptcy and to help them improve their money management skills. The legislation requires individuals to complete a credit counseling session prior to filing for bankruptcy. After filing, they must complete a financial education course before they are permitted to discharge their debts.

To investigate the impact of the legislation's educational requirements, Angela Lyons, an associate professor of agricultural and consumer economics at the University of Illinois, launched a multiphase study in collaboration with Money Management International (MMI), the nation's largest nonprofit, full-service consumer credit-counseling agency.

"The goal of this study is to track debtors through the entire bankruptcy process and follow up with them three to six months afterwards to assess the long-term impacts of the educational requirements on their overall financial well-being," Lyons said.

According to Lyons, the educational requirements of the bankruptcy legislation have come under considerable scrutiny. "There is concern regarding whether or not the legislation is creating an administrative obstacle for people who are in dire financial straits, many of whom may be in trouble due to circumstances not in their control," Lyons said.

Opponents of the educational requirements argue that some debtors may be in serious financial debt due to having large medical bills or due to unemployment, as examples. These individuals may know how to manage their finances, but through no fault of their own are now in serious debt.

Proponents of the legislation stress that the required counseling session and financial education course have important educational value.

"Those who support the educational requirements believe debtors benefit by becoming better informed about the bankruptcy process and alternatives to filing for bankruptcy," Lyons said. "They feel debtors also learn important basic financial management skills to help them get back onto their feet and get a fresh start."

Do the educational requirements help individuals get a "fresh start" financially? Are debtors able to put into practice what they learned from the counseling?

Lyons and her colleagues at MMI sought to measure and quantify the educational value of the initial counseling requirement in the first phase of the research study. During the 60- to 90-minute counseling session, debtors are taught basic personal finance concepts; assess their income, expenses, assets, and liabilities; and look for ways to increase their income or cut expenses to improve their financial situation. More than 32,000 debtors who participated in MMI's bankruptcy counseling course were surveyed to measure changes in their financial knowledge, current and intended behaviors, and overall satisfaction with the bankruptcy counseling and education.

"We found that, overall, debtors did see improvement in their financial knowledge, attitudes, and behavioral intentions," Lyons said. "More than 99 percent of the participants indicated the counseling course was helpful."

"We also found that, typically, there are multiple factors that lead individuals to file for bankruptcy. Even for those individuals who were in debt due to medical bills or unemployment, there were other money management factors at play. However, no matter what the reasons were for individuals getting into significant financial debt, they still benefited from taking the counseling course."

To receive a complete copy of the study and learn more about the impact of bankruptcy counseling and education on debtors' financial well-being, visit <http://www.cefe.illinois.edu/research/reports/>.

Phase two of the study, which is currently underway, examines the long-term impacts of the educational requirements by following up with debtors after they complete the entire bankruptcy process.

"Preliminary evidence points to marked improvements in financial management skills and practices, which suggest that credit counseling and education may in fact be a viable mechanism to help debtors deal with their financial situation and obtain a fresh start," Lyons said.