A New Role for United States Trustees: Approval of Credit Counseling Services

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Introduction

Last year, the House of Representatives and the Senate each passed a different bankruptcy reform bill containing wide-ranging changes in the bankruptcy laws applicable to individuals.[2] Although the House and Senate conferees offered compromise legislation in the Conference Report on H.R. 3150, that bill was not enacted before the end of the 105th congressional session.[3]

On February 24, 1999, a nearly identical version of the former House Conference Report was introduced in the 106th Congress as H.R. 833, the "Bankruptcy Reform Act of 1999."[4] On March 16, S. 625 was introduced in the Senate.[5] [Note: On May 5, the House passed H.R. 833, as amended.[6]] Although

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[2]*See* H.R. 3150, 105th Cong., 2d Sess. (1998); S. 1301, 105th Cong., 2d Sess. (1998).

[3]*See* H.R. Conf. Rep. No. 794, 105th Cong., 2d Sess. 9954-9985 (1998)(passed by the House but not voted on in the Senate).

[4]*See* H.R. 833, 106th Cong., 1st Sess. (1999).

[5]*See* S. 625, 106th Cong., 1st Sess. (1999).

[6]Omnibus bankruptcy reform bills have consistently required the United States Trustee Program to approve credit counseling services for pre-bankruptcy credit counseling. However, as this article went to press, the House adopted Amendment #35, offered by Calvin Dooley (D-Calif.), which would require the United States Trustee to approve only credit counseling agencies that satisfy standards set in regulations promulgated by the Federal Trade Commission and that are accredited by the Council on Accreditation or an equivalent third party nonprofit accrediting organization. *See* H.R. 833, Sec. 302(e), amending 11 U.S.C. § 111(a)-(e). This article does not examine the effect of Amendment #35.

different in some respects, both S. 625 and H.R. 833[7] contain credit counseling provisions. If enacted, these provisions would establish new duties for the United States Trustee Program,[8] including the duty to "approve" credit counseling services for use by individual debtors who wish to file for bankruptcy. This article discusses the new duties for debtors and United States Trustees as set forth in H.R. 833. It includes background information on credit counseling services and debt repayment plans. It also highlights issues raised by this new area of responsibility for the United States Trustee Program.

What is a Credit Counseling Service?

One need only peruse any metropolitan telephone directory to discover the wide spectrum of organizations that advertise credit counseling services. Credit counseling services are available from nonprofit organizations, for-profit organizations, schools, churches, legal-aid organizations, and attorneys, among other providers.

HR. 833 does not define "credit counseling service." For purposes of this article, "credit counseling service" means an organization that exists and functions to serve its consumer debtor clients and their creditors by attempting to resolve debts through the formulation of individual debt repayment plans. The credit counseling service seeks, when possible, reduction of the amount of debt and reduction or elimination of fees and charges accrued on the debtor's accounts. The debt repayment plan provides for payment to creditors over a period of time during which creditors withhold enforcement of their claims. Generally, clients are expected to stop using their credit cards and to refrain from applying for any new credit during the term of the repayment plan. The purpose of the plan is to settle the client's debts and repay creditors.

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[7]All references in this article are to H.R. 833 before passage as amended by the House on May 5, 1999.

[8]The United States Trustee Program is a component of the Department of Justice. The Program acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system. It works to secure the just, speedy, and economical resolution of bankruptcy cases; monitors the conduct of parties and takes action to ensure compliance with applicable laws and procedures; identifies and investigates bankruptcy fraud and abuse; and oversees administrative functions in bankruptcy cases.

New Duties For Debtors and United States Trustees

A. Notice of Alternatives

As set forth in H.R. 833, an individual who wishes to file a bankruptcy case would receive a written notice of alternatives containing: (1) a brief description of chapters 7, 11, 12, and 13 and the general purpose, benefits, and costs of proceeding under each chapter; (2) a brief description of services that may be available from a credit counseling service; (3) warnings about penalties for concealment of assets and false oaths or statements; and (4) notice of the possibility of an audit.[9] Unless the court ordered otherwise, an individual debtor (or debtor's attorney or bankruptcy petition preparer) would have to file a certificate with the court to show that the debtor received and read the notice of alternatives. If the debtor failed to file a certificate within 45 days after filing the bankruptcy petition, the case would be dismissed automatically on the 46th day.[10]

B. Credit Counseling Requirement

Under H.R. 833, individuals who wish to file a bankruptcy petition would be required to undergo credit counseling through an approved credit counseling service within 90 days before filing the bankruptcy petition.[11] The requirement would be fully waived only if the United States Trustee determined that the approved credit counseling services for a district

[9]H.R. 833, Sec. 103 amends 11 U.S.C. § 342(b) to require individual debtors to be given a notice of alternatives.

[10]H.R. 833, Sec. 603(b) amends 11 U.S.C. § 521(a)(1)(B)(iii)(I), (II) to require the filing of a certificate regarding the notice of alternatives. H.R. 833, Sec. 604 amends 11 U.S.C. § 521(b)(1) to provide for automatic dismissal of a case for failure to timely file schedules or provide information as required by 11 U.S.C. § 521(a)(1) by day 45 post-petition.

[11]H.R. 833, Sec. 302(a) amends 11 U.S.C. § 109(h)(1) to restrict who may be an individual debtor with primarily consumer debts, in all chapters, to one that has received credit counseling, including at a minimum, participation in an individual or group briefing that outlined the opportunities for available credit counseling and assisted that individual in performing an initial budget analysis, through a credit counseling service approved by the United States trustee within 90 days pre-petition.

were not reasonably able to provide adequate services for the additional individuals who would otherwise seek such services.[12] United States Trustees would annually review any such determination.

Under H.R. 833, if certain exceptions or exigent circumstances applied, a debtor would be permitted to file the bankruptcy petition first and then undergo credit counseling within 30 days post-petition.[13] In either case, a debtor would have to file with the bankruptcy court a certificate of compliance from the credit counseling service and a copy of the debt repayment plan, if any, developed through that service.[14] Automatic dismissal would not occur if a debtor failed to file a certificate from a credit counseling service pre- or post-petition. Instead, the United States Trustee or a party in interest could move to dismiss the case under 11 U.S.C. § 707(a), § 1112(b), § 1208(c), or § 1307(c), based on the debtor's ineligibility under § 109(h).

The credit counseling provision would require debtors to participate in an individual or group briefing that outlines opportunities for available credit counseling and helps them perform an initial "budget analysis." Although the term "budget analysis" is not defined in H.R. 833, it appears to contemplate an analysis of the debtor's income and expenses, including all secured and unsecured debts and considering the debtor's available disposable income, to determine whether the debtor can pay creditors through a debt repayment plan without imposing undue hardship on the debtor or the debtor's dependents.

The United States Trustees would have responsibility for approving credit counseling services. Approved services would be included on a list provided to debtors and maintained by

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[12]H.R. 833, Sec. 302(a) amends 11 U.S.C. § 109(h)(2).

[13]H.R. 833, Sec. 302(a) amends 11 U.S.C. § 109(h)(3) to provide for exceptions to the pre-filing credit counseling requirement. The exceptions include (1) the debtor certifies that exigent circumstances merit a waiver, (2) debtor was unable to obtain services within five days, and (3) debtor submits a certification that is satisfactory to the court. An exemption ceases to apply 30 days after filing a petition and the debtor is required to undergo credit counseling post-petition.

[14]H.R. 833, Sec. 302(d) amends 11 U.S.C. § 521(d).

the bankruptcy clerk for each judicial district.[15] Only the listed agencies would be authorized to provide the certificates of compliance that debtors must file with the bankruptcy court. The credit counseling provisions would take effect 180 days after the date of enactment of the Act.[16]

How Do Credit Counseling Services Operate?

The United States Trustee Program has been working to become acquainted with the nature and operations of credit counseling services in anticipation of the need to develop criteria for approval of those services that are equipped to render good service. The Program has met with representatives of nonprofit credit counseling organizations and with executives of large, multi-state agencies to learn about their policies and practices. Staff have also examined the great variety of state laws applicable to credit counseling services.

During this process it became apparent that the prototypical credit counseling service is part of a highly fragmented and competitive industry. The industry's many organizations and autonomous units have diverse operational policies and methods, charge different fees, and offer services of varying quality. While most of the providers declare similar core purposes--to extend and work out payment programs for individuals overloaded with debt--and most appear to serve their clients effectively, they depend almost entirely for their income not upon the debtors they serve but upon the creditors they pay. The organizations receive funds from creditors in the form of a negotiated percentage fee based on payments transmitted to the creditors through clients' debt repayment plans. This negotiated percentage fee is known in the industry as a "fair share" and may range from 0 percent to 15 percent of the payments. Nonprofit organizations also may charge their debtor clients small fees that are characterized as "donations."

There are several national associations that encompass most of the nonprofit segment of the industry, but have no regulatory powers. There are also numerous independent

[15]H.R. 833, Sec. 302(e) amends 11 U.S.C. § 111(a).

[16]H.R. 833, Sec. 1201.

nonprofit providers--among them large-volume, multi-state operations that operate through toll-free telephone numbers or the Internet, rather than through face-to-face consultations with debtors in local offices. It is estimated that more than 1,450 nonprofit credit counseling services operate in the United States.

Although the members of the nonprofit associations may comply voluntarily with the associations' internal standards, they are generally unregulated by state laws or regulations. Most states exempt nonprofit credit counseling services from their laws governing credit counseling providers. Several states have no laws at all governing the operation of credit counseling services. Only a few states[17] have laws applicable to both nonprofit and for-profit credit counseling services that provide for oversight and licensing or registration of such services.

For-profit credit counseling organizations generally fall within the purview of a majority of states' applicable laws and regulations, but the quality and type of services they provide are variable. In some cases, the fees they charge clients are higher than those charged by nonprofit groups.

Debt Repayment Plans

Nonprofit credit counseling services offer a variety of services that may include counseling, debt repayment plans, and education. Typically, when an individual contacts a nonprofit credit counseling service to inquire about a debt repayment plan, he or she will be asked to provide information to a credit counselor. This may take place in person, through a toll-free telephone number, by fax transmission, by mail, or over the Internet. Such information may include personal data, gross and net monthly income from salary, income from other sources, assets, monthly living expenses, housing data, a list of creditors, a list of debt obligations, and account and payment data. This information is used to evaluate the client's financial situation to determine whether a debt repayment plan is a viable option. Some providers require clients to sign an agreement and other authorization forms.

[17]States that have laws applicable to nonprofit credit counseling services include Illinois, Iowa, New Jersey, Oregon, Rhode Island, Utah and Virginia.

Credit counseling services may be free to the client or may involve a monthly fee.

If a debt repayment plan is developed, it is likely to provide a payment schedule tailored to the client's needs and ability to repay. The plan may include reduced payments to creditors and reduced or waived finance charges, late fees, and over-limit fees. Each month, the client transmits a payment to the credit counseling service, which in turn transmits payments to creditors. While most creditors pay a "fair share" to the credit counseling service, each creditor credits the client's account with 100 percent of the payments. Clients may receive regular reports on the status of their accounts. Significantly, most credit counseling services handle only unsecured debt, so clients must continue to make payments to secured creditors and other creditors not included in the repayment plan.

Most creditors do not stop charging interest during a debt repayment plan. In addition, creditors may close or suspend a client's line of credit, including credit card accounts, during a plan. Some repayment plans permit the client to maintain one credit card, but almost all plans require the client to agree not to apply for or incur any more debt during the plan.

Creditors may report to a credit reporting agency that a client is not paying as originally agreed, even though the creditors have accepted a reduced payment through a debt repayment plan. A debt repayment plan that appears on a credit report could have a negative impact on a client's ability to obtain credit, rent an apartment, or find employment in the future. This negative information may remain on a credit report for seven years, whereas a bankruptcy case appears on the report for 10 years.

When a client completes repayment under a plan, some creditors will reestablish the client's credit, based on his or her ability to pay and payment history under the plan. Some credit counseling services try to help clients reestablish credit. It is not uncommon for a debt repayment plan to take four years or longer to complete.

The United States Trustee Program has been advised that clients typically have an 80 percent debt to income ratio when they seek credit counseling from a nonprofit organization.

About one third of all clients opt to develop a debt repayment plan. Out of that one third, approximately 50 percent of the clients who begin debt repayment plans complete their plans, while the remaining 50 percent generally drop out within six months to one year. By comparison, approximately 35 percent of all chapter 13 debtors complete reorganization plans, with the balance of the cases being dismissed or converted.

Another one third of all clients who seek nonprofit credit counseling are able to work out their finances without a debt repayment plan. About 23 percent of all clients need to take some other type of action, such as seek part-time employment or address substance abuse. Approximately 10 percent of all clients who seek nonprofit credit counseling file for bankruptcy.

Standards for Approval

If pre-bankruptcy consumer counseling requirements are enacted, the United States Trustee Program will develop standards for approval of credit counseling services throughout the country. It is anticipated that the approval process will involve an application, which relies not only upon the applicant's disclosures, but also upon verifications from other sources whenever possible. This design seeks to maintain the integrity of the assessment process, while limiting the work required of field offices, particularly given uncertainty over whether Congress will provide funding for this additional responsibility.

The United States Trustees will apply the Program standards to select and approve credit counseling agencies for listing in each judicial district within their regions. Approval of a credit counseling agency will not mean that the United States Trustee warrants the quality of the agency's services or the success of its work. Rather, approval will mean that the credit counseling agency meets the minimum standards for operational integrity established by the United States Trustee Program.

Given that financially distressed people are very vulnerable and are often targets for scams and unscrupulous operators, the challenge in developing new standards will be to ensure that, to the extent possible, individuals are not directed to inappropriate services. The credit counseling industry handles approximately $6 billion annually, more than

the amount distributed from chapter 7 and chapter 13 bankruptcy cases combined. Credit counseling services function as fiduciaries because they handle and hold, for periods of time, substantial funds belonging to others. They are necessarily high-risk operations, as the possibility of defalcations is clearly present. The standards for approval must provide for full protection of moneys that belong either to debtors or creditors, while those funds are in the possession and control of credit counseling services.

To ensure operational integrity, the standards for approval are expected to require the credit counseling agency to use trust accounts, or other such means, to preserve and safeguard funds; engage in regular oversight and monitoring of all receipts and distributions of client deposits; and obtain regular audits of the accounts from outside auditors. Of particular concern is how credit counseling agencies cover possible losses through fidelity bonds or insurance. Further, it is likely that the standards will address the need for agencies to make periodic status reports to clients about payments to creditors. They may also require an agency to make certain disclosures to clients, including whether the agency is funded from the creditors' "fair share." General quality of performance of credit counseling services will also be addressed in the criteria for approval. In addition, the standards will address the need for each agency to provide training for credit counselors and have experience in the credit counseling business.

To retain the Program's approval, credit counseling services will be required periodically to demonstrate continued compliance with the Program's minimum standards and policies. Credit counseling services that do not meet the criteria will be removed from the approved list provided to debtors. The procedures and standards for approval and concomitant removal of agencies will be set forth in an administrative rule to be adopted.

Conclusion

The implementation of a pre-bankruptcy filing requirement of credit counseling for debtors, a new role for United States Trustees, and standards for approval of credit counseling services, depends upon the enactment of bankruptcy reform legislation that contains the credit counseling provisions. The pre-bankruptcy filing requirement of credit counseling is

a new concept in bankruptcy law, creating new responsibilities for debtors and United States Trustees. Under H.R. 833, credit counseling services would, in effect, become the "gatekeepers" of the bankruptcy system because individuals would be ineligible to file for bankruptcy unless they first obtained a certificate from a credit counseling service approved by a United States Trustee.

The United States Trustee Program is working to ensure that debtors are referred to credit counseling services that are dependable, responsible, skilled in their work, and responsive to both debtors and creditors. The goal will be to design a system that ensures that the counselors who are approved will function with ongoing integrity and success. With that goal in mind, a system can be structured that fulfills the intent of Congress and the needs of debtors, creditors, the bankruptcy courts, the United States Trustees, and all parties interested in the bankruptcy process.