

YOUR MONEY

Volume III, Issue VIII

September 2005

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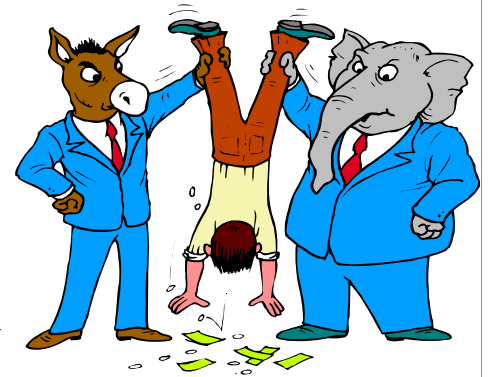
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The New Bankruptcy Bill..... What Does It Mean?



Bankruptcy change legislation passed Congress last week in a 302 to 126 vote and was signed into law 4/20/05 by President Bush . The changes introduced by this bill are tough on consumers and good for banks. Banks are having their cake and eating it too, as the saying goes.

This bill has been in the works for eight years. President Clinton vetoed the measure back in 2000 and the banks have been fighting ever since then to get it back on the table. Success for them is at hand, unfortunately for us.

The idea behind amending the bankruptcy law is to stop people from taking advantage of the system. Stop those who would abuse the law by hiding their assets in states where exemptions allow this protection and then claiming bankruptcy, thereby shedding their debt but still holding on to equity.

The reality is that the vast majority of those people seeking bankruptcy protection are not defrauding the system. These are legitimate claims of people who need a fresh start which is what bankruptcy law should be about.

Harvard Law School professor Elizabeth Warren, in her bankruptcy study found that the 90% or more of bankruptcies are still filed by people who get sick, get laid off, or get divorced, not by abusers. Even the industry can only show that 3% of those that go bankrupt might be abusing the system, still, this new law would harm all debtors.

Here are a few highlights of how bankruptcy law is affected:

Chapter 7 means test

Those seeking Chapter 7 must comply with income requirements. That means that they must make less than their state's annual household median income and have less than \$100 per month available to repay their debts otherwise they will be forced to do a Chapter 13 bankruptcy. In Chapter 13, debtors restructure their debt and pay much of it back thereby losing that fresh start.

Increased cost of going bankrupt

Bankruptcy lawyers will be charging more fees because there will be more paperwork and time in court. Also, the attorneys must protect themselves because the new law has reforms that could possibly hold them liable if their clients commit fraud.

Cost of living

The IRS (Internal Revenue Service) guidelines will determine allowed monthly spending for food, housing, clothing, etc. After taking these into account, the amount remaining must be used for debt repayment.

Forced credit counseling

Bankruptcy filers must seek credit counseling for at least 6 months. This will also increase costs since they must pay counselors. However, I believe this requirement, and other aspects of the law, will ultimately hurt the credit counseling industry. For one, people will simply want to fulfill this requirement so they can go bankrupt, and two, banks will reduce the "fair share" to counselors. Fair share is the percentage of the debt paid to counselors for helping to get consumers to pay. Banks will reduce this amount further because they know that people won't be able to avoid paying the debt back so why should they pay more to have it collected.

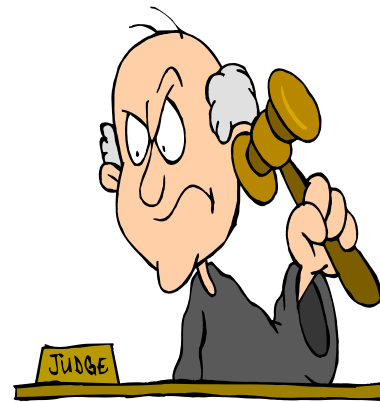
Should I Declare Bankruptcy?

In 2004 there were about 1.6 million bankruptcies in the U.S. According to the U.S. Federal Reserve, the typical filer has about 1.5 times their annual salary in short-term, high interest debts (like credit cards and personal loans). About 2/3 of the those filing say that they have lost a job and about 1/2 have faced a serious health problem.

There's a Federal law that authorizes bankruptcy and then state law determines things like what property you can keep through a bankruptcy.

Basically, a bankruptcy discharges certain debts and says that the creditor is no longer entitled to repayment. The purpose is to allow the debtor to get a fresh start and creditors to get an equitable distribution of any assets.

Just because debts are eliminated doesn't mean that the slate is wiped completely clean. Debts discharged in bankruptcy will appear in your credit history for 10 years. There are also some debts that a bankruptcy won't eliminate. Back taxes, alimony, child support, and student loans are not discharged.



When is it time to throw in the towel and file for bankruptcy?

Bankruptcy should only be used when the other alternatives have failed. When minimum monthly bills are more than the family can pay, the first step is to contact the creditors and ask for a payment plan. If that doesn't provide enough breathing room, it's time to contact a qualified credit counseling agency. They can negotiate the interest rates down.

Neither of those steps will reduce the amount owed. It will only cut interest rates and create a more livable payment plan. Sometimes, that's not enough. If a credit counselor can't work out a plan to pay off your debts in less than five years, then it's time to consider something more drastic.

In the U.S. a chapter 13 bankruptcy filing is meant for people with a regular source of income and enables them to keep some valuable property (such as a house) while putting together a payment plan that usually runs 3 to 5 years. Payments must be completed under the plan before the remaining debts are discharged.

If your income is only enough to cover living expenses without repaying debts, a chapter 7 bankruptcy could be appropriate. If there's income available for debts, it's the court's responsibility to redirect the debtor to Chapter 13 filing.

In a Chapter 7 filing, the court appoints a trustee. The trustee collects the debtor's assets, sells them and then pays the money out to the creditors. Some items are exempted from the sale. After the proceeds are distributed to creditors the remaining debts are discharged.

There are other things to consider when deciding whether to file for bankruptcy. Bankruptcies are public records. In the past you could be pretty sure that no one would find out unless you told them. But, in today's interconnected world that's not so sure. It's also possible that the debtor has some asset that they could lose during bankruptcy. For instance retirement accounts or valuable family heirlooms could be liquidated.

There will be filing fees, typically about \$200. Your lawyer will get about \$1,000 in fees, although you can keep that down by having current statements on all your income and debts. Many will offer one free consultation.

Finally, there is one reason to smile despite the challenge you are faced with There was a time in old England where a person unable to pay their debts could get the death penalty! Fortunately that law doesn't apply today and no one is adding it to any proposed legislation.