

## **Bankruptcy Reform and Education**

The purpose of this panel discussion was to acquaint ACCI members with bankruptcy counseling programs and related research, as well as provide a brief up-date on the bankruptcy legislation pending before Congress. Information on Canada's mandatory counseling program and new mediation program was provided. The panel was moderated by Jean M. Lown.

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### **San Antonio's Chapter 13 Debtor Program**

Sandi Martin, Financial Education Director for San Antonio's debtor program, provided an overview of the program. San Antonio's debtor program, which is the second oldest in the U.S., was implemented in 1976. The program has always been mandatory, although previously there were no repercussions against those who did not show up. San Antonio's program has been successful with 48% completing their payback plan (compared to 31% nationally), and with 67% paying back 70% or more of their unsecured debt (compared with 36% nationally).

In July 1999, the program was revised. Chapter 13 filers are ordered by the court to attend a class prior to their meeting with creditors. The creditor meetings take place on Wednesday afternoons and the class is held Wednesday mornings. If the debtor does not attend the class, then the meeting with the creditors does not take place. A second class had been offered for those who completed their Chapter 13 plan, i.e., those who had completed 70% or more of their payback plans, in order to give them information on how to reestablish credit. Because there had traditionally been low attendance at the second class, it was dropped, and the information is now presented in the Wednesday morning class. Every Chapter 13 filer is mailed a "fresh start" package which includes information on how to develop a budget and how to reestablish credit.

Very few Chapter 13 programs have any kind of debtor financial management class. A core curriculum is currently being developed to be used nationwide based on what has been done in San Antonio. The class evaluations indicate that Chapter 13 filers appreciate the information presented, and read the materials they receive. "This gave us a positive, hopeful, realistic look at our future." "I learned that having lots of bills keeps me from doing the important things in my life."

### **Research on Debtor Education Programs**

Pamela P. Stokes, Texas A & M University - Corpus Christi

Preliminary research provides some evidence that debtor education pays off in terms of short- and long-term results for debtors. Three studies have been done on debtors attending financial management classes, all indicating the classes provide tangible and real benefits to participants.

Money management classes for Chapter 13 debtors have been taught since late 1992 in the South Texas regions of Corpus Christi, Harlingen, Victoria, and Laredo. The classes are mandatory for participants, and combine traditional financial management concepts with goal setting and personal motivation techniques. Little time is spent on the administrative or legal aspects of the bankruptcy process, so research has been centered solely on behaviors and characteristics associated with money management. The debtors are required to attend one class, which is three hours in length.

First of all, initial post-class evaluations were very positive and indicated that debtors had learned a lot of helpful information. Furthermore they enjoyed the classes, even though they were under some compulsion to attend. The average ratings on a 1 (poor) to 5 (excellent) scale were as follows for the eight areas of inquiry: degree course objectives were met, 4.6; instructor knowledge, 4.9; instructor presentation, 4.8; course length appropriate, 4.5;

usefulness of skills learned, 4.6; course materials, 4.6; recommending the class to others, 4.7; and overall effectiveness, 4.7 (Stokes, 1995).

Second, results from a follow-up study evidenced positive changes in the money management practices of the respondents twelve to eighteen months after the class. As to what extent the class improved their money management skills, 35.8% said "very much," 47.5% "somewhat," 7.5% "a small amount," 2.5% "not at all, even though I used them," and 5% "not at all because I did not use them." The five most valuable topics in descending order were budgeting, goal setting, personal choice, use of credit, and comfort zones. A surprising number (45%) indicated they used the ideas presented "many times," while 38.3% said "a few times," 3.3% "once or twice," and 5% "not at all" (Stokes, 1995).

Third, in an effort to find out why the class was effective, a pre- and post-class survey measured changes in the economic locus of control of participants. The post-class survey was done one to twelve months after attendance at the class to avoid a potential "halo effect" immediately after the session. The results indicated a shift from an external to an internal locus of control. Basically this means the debtors changed somewhat toward a more positive perception of their ability to actively control and manage their financial affairs. Presumably, as a result, they will be more proactive in making good financial decisions, and not as easily influenced by negative people or pressures (Stokes, 2000).

As a result of many years of teaching the classes with various materials, and assessing the research, the author has certain conclusions about areas of current debate regarding debtor education.

1. Classes should be enjoyable and contain a motivational component. Debtors report varying degrees of personal stress, depression, and low self worth connected with filing bankruptcy. While the "hard core" financial information is important, the mind set of the debtors is equally significant if we are to enable them to change their habits and take control of their finances.
2. Material must be immediately practical and useful. It is important to give them ideas or techniques they can use when they walk out of the class -- not just theory.
3. Participatory exercises should be used to actively engage the participants. Such techniques not only make the class more interesting, they result in longer retention of concepts.
4. Classes should be mandatory. A problem with voluntary attendance is that the people who most need the information do not come. Ironically, the reasons for non-attendance are the same ones that the financial problems -- avoiding "uncomfortable" topics, blaming "others" for their situation, procrastinating, reactive v. proactive problem-solving, and so forth. Many individuals who initially indicate they don't want to be there, are the ones who are most effusive in their thanks and appreciation afterwards.

Bankruptcy debtors may be unusually receptive to financial education, and it is important to take advantage of this "teachable moment." These studies indicate that even a brief class can make a positive difference. Debtor education programs and related research should clearly be expanded and encouraged.

### **An Overview of Recent Changes in Canada's Bankruptcy Legislation**

Ruth E. Berry, University of Manitoba

During the past decade, Canada's Bankruptcy Act, originally proclaimed in 1919, has undergone several major changes. This includes a change in name of the act to the Bankruptcy and Insolvency Act, the introduction of consumer proposals, and the provision of mandatory counseling prior to an unconditional discharge. Canada's bankruptcy legislation prior to 1919 applied only to traders and other corporate entities. Based on the British bankruptcy act of 1883, Canada's legislation, unlike that of the United States, has not been predicated on the concept of a "fresh start" for consumer debtors. All aspects considered, American consumer insolvency law is much more pro-debtor than Canadian law, especially considering the 1997 amendments.

There is also some provincial involvement in the bankruptcy process, with the courts permitting limited overlap between the two jurisdictions--for example, each province controls the type and value of assets which are exempt from seizure, and these can vary from \$3,800 to \$62,000 per person. Although there has been extensive discussion in the American literature on the relationship between high exemptions and bankruptcy rates, there seems to be no consistent correlation between these two factors. Another variation by province is the availability of provincial debt management programs, which have been active in western provinces, and allow repayment of debt over a 4-year period under Chapter X of the Bankruptcy and Insolvency Act.

Bankruptcy rates in Canada escalated by 400% between 1985 and 1997; the same four fold increase occurred in the U.S., however in 1997 there were about 90,000 consumer insolvencies in Canada compared with 1,350,000 in the United States. Since Canada has approximately one-tenth of the population of the U.S., the actual bankruptcy rate is somewhat higher in the U.S.

The most recent revisions were in 1992, 1997 and 1998. The 1992 changes were the most sweeping, especially the addition of mandatory counseling. There are many shortcomings to the counseling, although a preliminary study considering the effectiveness of this measure showed it to be very positive in the opinion of the debtors. A further study was planned for 1999, but this work has been postponed and no definite plans for another study are known.

The 1997 amendments require the trustee to fix the share of the debtor's income that the debtor is required to pay the trustee for distribution among the creditors. This is very different than the American system. The trustee now must determine the debtor's available surplus income which in 1999 was any income above \$1,492 for a single person, \$1,864 for a couple and \$2,319 for a family of three. These revisions also included a provision for mediation, which will be discussed by another panelist.

In 1998, a small change was made which affected the discharge of student loans through bankruptcy. Now students must wait for 10 years after graduation or their leaving school before they can include a student loan in bankruptcy proceedings.

### **Consumer Bankruptcy Mediation Process in Canada**

Sue McGregor, Mount Saint Vincent University

As of April 1998, the *Canadian Bankruptcy and Insolvency Act* (BIA) was amended so that there is a mediation process in place. A third party (currently trained employee of the Office of the Superintendent of Bankruptcy (OSB)), helps resolve disputes about: (a) how much the bankrupt should pay to the creditors, above and beyond living expenses and a certain standard of living, and/or (b) the conditions that are put in place when releasing (discharging) the bankrupt.

#### Mediation if Parties Cannot Agree on How Much to Pay the Creditors

Earlier in the bankruptcy process, mediation can be used to help determine the amount of surplus income (money paid by the debtor and given to the creditors by the trustee) if the trustee, creditors and bankrupt cannot agree. Mediation related to surplus income is available to both first time and repeat bankrupts. Surplus income is defined as money left over after the trustee calculates how much is needed to meet a certain standard of living (calculated using Directive #11 on surplus income <http://osb-bsf.ic.gc.ca>). If the person going bankrupt does not agree with the trustee's calculations, the trustee must send this objection to the OSB requesting mediation. If the creditor does not agree, s/he has until 30 days after the person entered bankruptcy to object and request mediation. When agreement is reached, a "mediation settlement agreement" is signed by all parties. If no agreement can be reached, the trustee may apply to the court for the judge to decide the matter and the trustee must go to the court for determination if the creditor or officials at the OSB request it. If, at some time in the future, the circumstances of the bankrupt change, the court can modify the amount to be paid for surplus income.

#### Mediation for Discharge Dispute

Later in the process, mediation can be used if there is disagreement about the conditions to be met for discharge from bankruptcy, available only to first time bankrupts. Also, creditors and trustees can request mediation if: (a) the bankrupt did not pay the agreed amount into their estate, (b) if the total amount paid into the estate is small compared to the bankrupt's debts or financial resources, or (c) if the bankrupt opted for a liquidation when s/he actually qualified for a repayment plan (consumer proposal). If no agreement can be reached, the trustee must apply to the courts for a decision which is binding on the bankrupt.

#### Preliminary Statistics about Mediation

Mediators currently are trained employees of the OSB or a mediation trained or experienced individual who has been approved by the OSB. As of February, 2000, 128 mediations have been arranged. Two thirds of the mediations were established to settle surplus income issues (66.4%) and the other third to settle conditions for discharge from bankruptcy (33.6%). Over half (54%) of the mediations to settle surplus income were requested by the trustee followed by the creditor (36.5%) and, to a much lesser degree, the debtor (9.5%). Of the surplus income

mediations, 80% were resolved, 13% were cancelled by the mediator and 8% were not resolved, meaning they had to go to court. Mediation to settle conditions for discharge from bankruptcy were requested by the trustee (43%), the debtor (31%) and the creditor (26%). Almost seventy percent (68.4%) were settled, 18% were cancelled by the mediator and 13% were not resolved. Overall, mediation seems to be effective in resolving disputes related to how much income to pay into the estate and settling conditions for discharge from bankruptcy.

### Discussion

When asked about counselling programs aimed at Chapter 7 filers, Sandi Martin stated that “Chapter 7 filers are like quicksilver – some don’t even know they have filed for bankruptcy.” A voluntary program has been initiated in Nashville, TN for Chapter 7 filers but there is no indication of its efficacy. VISA has produced a program for Chapter 7 filers and is soliciting trustees to use their materials.

Texas debtors have run into a problem with mortgage companies that is confounding the debtors’ ability to recover from their over-indebtedness. Chapter 13 filers have a “protection” period during which mortgage companies cannot take action against them. A number of Texas Chapter 13 filers have recently found that during the protection period, mortgage companies have raised their mortgage payments (relative to a variable rate mortgage) or the escrow payments (due to increases in property taxes and/or insurance premiums). The Chapter 13 filers were not notified of these changes because a mortgage company is not supposed to have any contact with the filer during the protection period. These Chapter 13 filers find that they are in arrears on their payments and in danger of losing their homes to foreclosure.

What materials are being used in debtor education programs? According to Ms. Martin, Bankruptcy Trustees trust each other more than outsiders. Nationally, the Trustees are trying to establish basic concepts that need to be covered in debtor programs. If education becomes mandatory, the effectiveness of these programs will need to be assessed, so key competencies need to be taught in all programs. If the current bankruptcy bill is passed by Congress requiring debtor education programs, the programs will have 180 days to get started.

### References

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### Endnote

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