

Chapter 9-Section 2

Debt Management

Bankruptcy

- A legal procedure to relieve a person of excessive debt
- Granted by a federal court
 - Voluntary bankruptcy-the individual asks the court to declare bankruptcy
 - Involuntary bankruptcy-creditors petition the court to force a debtor into bankruptcy

Reasons for Filing Bankruptcy

- Common reasons for debtors to file for bankruptcy:
 - Excessive medical bills
 - Small business failure
 - Overspending and unwise use of credit
 - Losing employment and being overextended
 - Having no savings or emergency fund to access when unexpected events (losses) occur
 - Should be used as a last resort because of the damaging effects to credit rating

Bankruptcy Law

- Purpose:
 - 1. To give a debtor a fresh start
 - 2. To ensure fair treatment for creditors
- Bankruptcy is not intended to be used for reckless spending or to avoid responsibility
- Reasons to Avoid Bankruptcy
 - Bankruptcy damages a person's credit rating
 - Prevents consumers from getting low interest loans
 - Makes it difficult to obtain credit to buy a home
 - Can impact the purchase of life insurance
 - Can impact employment
 - Stays on credit history for 10 years

Financial Strategies to Avoid Bankruptcy

- Manage your debt load
- Establish an emergency fund
- Pay your bills on time or before the due date
- Don't over extend yourself with credit purchases

Credit Counseling

- A service to help consumers manage credit and avoid bankruptcy
 - Counseling available through nonprofit groups
 - Counselors work to:
 - Set up a budget for the consumer
 - Arrange a payment plan for debts
 - Provide lifestyle counseling
 - Help negotiate lower interest rates with creditors
- Debtors are required to receive credit counseling from a government-approved agency within 6 months before filing for bankruptcy

Debt Management

- A service that works with you and your creditors to create a workable plan for paying off debt. Your debt is managed for a period of time, usually 3-5 years.
 - Usually must turn over checking account and bills to a debt manager
 - Requires sufficient income to be able to pay the outstanding debt over an extended time period.
 - Usually a fee or commission charged for service
 - You must give up credit cards
 - Live on an allowance
 - Educated on how to prevent credit problems
 - After debt has been repaid, you get a fresh start

Debt Consolidation

- The process of getting one loan with a single monthly payment to pay off all of your debts.
- Purpose is for borrower to get a single loan payment with a smaller payment than the previous loans combined.
 - Debt consolidation loans require collateral to secure the loan
- Equity Loan-a second mortgage or debt secured with the equity of your home
 - Used to help pay off debt
 - Failure to repay this loan can result in the foreclosure of your home

Types of Bankruptcy

- All forms of bankruptcy create an automatic stay
 - This provides for immediate protection from any further action by creditors, including collection of debts
- Bankruptcy for Individuals
 - Chapter 7
 - Chapter 13
- Bankruptcy for Businesses
 - Chapter 11

Chapter 7 Bankruptcy

- A straight bankruptcy or liquidation bankruptcy-involves the forfeiture of an individual's assets in exchange for the discharge of debts
 - A discharge—is a court order that pardons the debtor from having to pay debts
 - The debtor's assets are sold
 - Money is used to repay as much of the debt as possible
 - Remaining debts are discharged (there are a few exceptions)
 - Debts that are usually discharged:
 - Credit card balances, bank loans, medical bills and court judgments
 - Debts that are not discharged
 - Tax debt, student loans, government fines for criminal charges, child support and spousal support
 - Must pass a Means Test
 - Means test-requires a debtor to confirm that his/her income does not exceed a certain amount

Chapter 7 Bankruptcy (continued)

- Before filing for bankruptcy:
 - Must pass the Means test—requires a debtor to confirm that his/her income does not exceed a certain amount
 - Must get credit counseling
- Debtors keep some property through exemptions
 - Exemption—Property that the debtor in bankruptcy does not have to forfeit to pay off creditors
 - Assets needed for survival (full list on page 293 in textbook, along with value)
 - Home
 - Motor vehicle
 - Tools of the trade

Chapter 13 Bankruptcy

- Known as individual debt adjustment for individuals
- Involves a repayment plan for some of the debt
- Designed for debtors who have a good source of steady income
- Court-approved plan to pay back as much debt as possible over a 3-to-5-year period
- After that time, remaining balances on debts are discharged if all the payments were made in the specified plan
- Creditors are forced to stop interest and late penalties
- While plan is in effect creditors cannot start or continue collection efforts.

Chapter 11 Bankruptcy

- Chapter 11-Reorganization of debts as decided by the court so that a business can remain viable
 - Purpose is to make sure that the business can be viable after the bankruptcy proceeding
 - Businesses retain possession of its assets and remain in operation after a plan for reorganization has been filed and approved by the court

Bankruptcy Fraud

- The abuse of bankruptcy laws in a way that favors the debtor and defrauds creditors
 - Serious Federal crime
- People who do not reveal or who try to hide assets from the bankruptcy court are committing bankruptcy fraud