Standard 13: **The student will evaluate the consequences of bankruptcy.**

Managing High Levels of Debt

Priority Academic Student Skills
Personal Financial Literacy

Objective 13.1: Assess the costs and benefits of bankruptcy to individuals, families, and society.
Objective 13.2: Examine ways to prevent bankruptcy and identify alternatives to bankruptcy (e.g., budget management, debt management, refinancing, and financial counseling).
Objective 13.3: Explain the importance of reestablishing a positive credit history and steps to improve a credit score after bankruptcy.

Lesson Objectives

⇒ Identify ways to deal with high levels of personal debt.
⇒ Compare the costs and benefits of filing bankruptcy.
⇒ Recognize the impact of filing bankruptcy.
⇒ Explain the importance of reestablishing positive credit history.
⇒ Demonstrate the steps to rebuilding positive credit history.

Montana and Carolina could not wait to graduate from high school and get married. They planned to go to college, if they could get student loans.

In their premarital counseling class on debt, they each were shocked to learn how much the other person owed.

Montana had a new truck. He borrowed money on his credit card for the down payment, tag, and title. He also booked their $5,000 honeymoon to Mexico on his credit card.

Carolina drove an old car. It was a "money pit," constantly costing her much money on repairs. She charged those repairs on her credit card, along with her clothes, shoes, dinners with friends, and everything else she wanted or needed. Her charges totaled $8,000.

Is this a good way to start a marriage? What do you recommend Montana and Carolina do to get control over their debt?

Personal Financial Literacy Vocabulary

Bankrupt: A person or company with insufficient assets to cover their debt.

Bankruptcy: A state of being legally released from the obligation to repay some or all debt in exchange for the forced loss of certain assets. A court's determination of personal bankruptcy remains in a consumer's credit record for 10 years.

Consumer credit counseling: Services offered by organizations that help consumers find a way to repay debts through careful budgeting and management of funds.

Creditor: A person or company to whom money is owed.

Debt consolidation loan: A single loan that replaces the debt owed by multiple loans, often with a lower monthly payment and a longer repayment period.

Financial counseling: Generally the same as consumer credit counseling.

Garnishment: A legal warning concerning the attachment of property to satisfy a debt.

Home equity loan: A loan secured by a primary residence or second home at the amount where the fair market value exceeds the over the debt owed on the property.

Repossession: To take possession of property in which the owner is behind in payments.

Introduction

Poor money management and overspending habits will quickly lead to high levels of debt, but that is not the only reason people face mountains of bills with little money to pay them. Events such as divorce, prolonged illness, or other personal problems can wreck a person's budget, causing them to get behind in their payments and face difficulties playing catch up.

When faced with unfortunate circumstances or the results of poor spending habits, there are ways to resolve the problem. Some of these include filing personal bankruptcy, getting debt counseling, or refinancing personal debt. These options have both costs and benefits to individuals, their families, and others impacted by the decision.

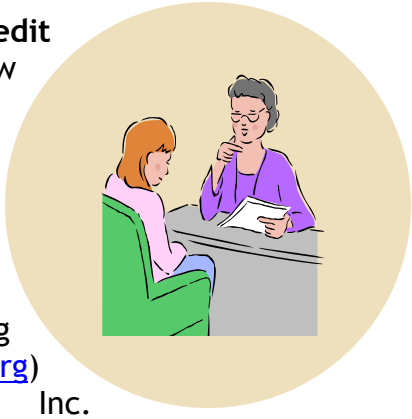
Lesson

Have you ever gone to the store — and then realized you left your money or credit cards at home? You are standing in the checkout aisle with no way to pay for your purchase. Now, imagine if you were in that position every month with little or no way to pay your bills, make your house payment, or buy food for your family. While it sounds almost impossible, there are families dealing with this scenario every month. Some of those families are in that situation because of failing to follow a good spending plan or not even having a spending plan! But many others face these problems for other reasons.

PRESENTATION
The multimedia slide presentation for this lesson outlines the content in this section. You may want to use it with your students, or print off the slides to use as lecture notes.

What can they do to manage high levels of debt? How can they ever overcome their financial problems and build a better quality of life for their families? How can they ever be able to afford to buy anything again? The answers to these questions are rather complex and vary from situation to situation.

If you find yourself facing this problem, here are some options to consider.



1. **Go for credit counseling or financial counseling. Credit counseling** or **financial counseling** is guidance on how to budget money and come up with a plan to pay as much debt as possible. You can go to an organization will help you restructure your debt so you can pay it off. As part of their service, you get help in knowing how to better manage your money. This type of service will set up a plan and monitor your progress in paying off your debt. Consumer Credit Counseling Services of Central Oklahoma (http://www.cccsok.org) and Consumer Credit Counseling of Oklahoma, Inc. (http://cccsofok.org) are two options for Oklahomans. Before contacting a credit or financial counseling service, you may want to check with the Better Business Bureau (http://welcome.bbb.org) to be sure they are a reputable company. Some of these organizations make promises they cannot keep, charge you money for their information, and then leave you with even more bills to pay.

2. **Refinance your debt.** You may consider a **debt consolidation loan** that will put all of your debt into one payment that is easier to manage. While it sounds like a great idea, beware of the potential costs before taking this step. If you had problems managing your money and paying your bills before you combined

them into one loan, you will probably have the same problem after combining them. It takes a change in behavior and a change in thinking to make a debt consolidation loan or any refinancing effort work.

3. **Get a home equity loan.** A home equity loan means that you borrow money on your house to pay your bills. It is very similar to a debt consolidation loan except the loan is against your home. This option has a high level of risk. If you fail to make your payments on the home equity loan, the lender may repossess your home. In other words, the lender could take your home away from you because you missed your payments. The lender would then sell your home to someone else to get back the money you owe.

4. **Go for credit counseling or financial counseling. Credit counseling** or **financial counseling** is guidance on how to budget money and come up with a plan to pay as much debt as possible. You can go to an organization — such as Consumer Credit Counseling Services — that will help you restructure your debt so you can pay it off. As part of their service, you get help in knowing how to better manage your money. This type of service will set up a plan and monitor your progress in paying off your debt. Before contacting a credit or financial counseling service, you may want to check with the Better Business Bureau to be sure they are a reputable company. Some of these organizations make promises they cannot keep, charge you money for their information, and then leave you with even more bills to pay.

5. **File for personal bankruptcy. Bankruptcy** is a legal process that allows you to either make reduced payments on your bills or erase them from your files. Keep in mind, however, bankruptcy actions stay on your credit history for ten years and will result in higher interest rates once you start to borrow money again.

What Does Bankruptcy Really Mean?

Being **bankrupt** means you are unable to pay your bills when they are due. Bankruptcy happens when you request legal action through bankruptcy meetings to get help with your bills because you cannot pay your creditors.

A **creditor** is someone to whom you owe money. Creditors have a right to collect the money you owe. Failing to pay creditors, for whatever reason, creates many problems for you. If a creditor is not receiving payments from you, it can call and demand payment, send letters demanding payments, take you to court for the payment, take part of the wages from your paycheck as a garnishment, refuse to give you more credit, and even take back what you purchased from them in a repossession.

Once you file bankruptcy, however, the creditor must stop trying to collect payments from you. With bankruptcy, you will repay the creditor only a fraction of what you owe—if anything. What you owe depends on what the bankruptcy trustee determines to be appropriate.

Bankruptcy filings are public record. Once you file, a meeting date is set, and you must appear before the bankruptcy trustee. Your creditors will also be part of the hearing, and they are allowed to ask you questions about your situation. In addition to providing all of your personal information to the bankruptcy trustee, you must also provide copies of your income tax returns for them to review.

Types of Personal Bankruptcy

Individuals can file two different types of bankruptcy: Chapter 7 and Chapter 13. Chapter 7 allows you to liquidate your debt while Chapter 13 reorganizes your debt. The bankruptcy process can take several months once you hire an attorney to file a **bankruptcy petition** on your behalf. A petition is a legal document that initiates the bankruptcy proceedings.

Once you have filed your petition, you will be required to attend a meeting with your creditors. Generally, the meeting involves you, your attorney, and a trustee from the bankruptcy court. As long as you have been honest with your attorney and meet the established provisions for filing, your petition will be approved.

Chapter 7

The purpose of Chapter 7 is to totally release you from all debt included in your bankruptcy petition. Chapter 7 (sometimes called Straight Bankruptcy) is designed to provide an orderly process where a bankruptcy trustee collects your assets, turns them into cash, and distributes the money to the people you owe. Bankruptcy laws, however, protect your right to retain certain items called exempt property. Being "exempt" means they are excluded from the bankruptcy process and cannot be taken by the trustee. The list of exempt property varies from state to state. Any remaining property is called non-exempt, and all non-exempt items can be seized by the bankruptcy trustee. Most people approved to file Chapter 7 have few, if any, non-exempt items.

Once you have been approved for Chapter 7 bankruptcy, you cannot file again for eight years from the date you started the first process—regardless of your debt level or financial situation. Should you decide to file bankruptcy, be sure to take it seriously because bankruptcy can have long-term consequences.

Chapter 13

Chapter 13 bankruptcy is a little different. It is commonly called Debt Adjustment because Chapter 13 allows you to file a repayment plan for you bills — allowing you to keep your personal possessions. If the plan is approved by the trustee, you have about three to five years to make reduced payments on your debt. Chapter 13 is only available if you have sufficient income to make those monthly payments, and all payments are made directly to the bankruptcy trustee who monitors your plan. During this period of time, your creditors cannot take any actions against you. Even under Chapter 13, you may not be required to repay all of the debt because most creditors will settle for a specific amount. Once you have fulfilled the repayment plan, you can basically start over—debt free. However, failure to make payments can result in serious consequences.

Whether approved to file Chapter 7 or Chapter 13, current bankruptcy laws require you to attend special debt counseling classes designed to help prevent you from repeating the situation. If you decide not to attend, your bankruptcy petition can be dismissed and you are back in debt with limited options.

When to File Bankruptcy?

Bankruptcy is not a substitute for money management skills. It should only be considered as a last resort for managing debt. Before filing, you should consider other options, such as financial counseling. Professional financial counselors will work with your creditors to resolve your payment problems.

If you are having problems paying your bills, you can call the creditors yourself and talk with them about the situation. Sometimes they will work with you to set up a new payment plan. Many creditors, especially banks, would rather work with you than see you file bankruptcy.

Top Reasons for Filing Bankruptcy

- Divorce
- Illness
- Gambling
- Unemployment
- Failing to Pay Taxes
- Medical Bills

A simple phone call to your creditors is often the best solution to your debt problems. Keep in mind that it is their option to work with you. They are not required to do so. Also, it is your responsibility to contact them for help. They will only contact you to demand payments.

Bankruptcy is a drastic action to take, but may be necessary so you can start over. If you have no savings and do not have enough income to pay your bills, you may want to talk with a bankruptcy attorney for advice on filing. Sometimes, due to a variety of circumstances, it is your best choice.

A Historical Perspective

The first bankruptcy laws were passed in England in the mid 1500s. Some of the early English provisions allowed for a person's ear to be cut-off or for individuals to be put to death if they failed to cooperate with their creditors. Bankruptcy legislation in the United States is based on English law, minus the physical punishment. Today's legislation is a modification of laws originally enacted in 1898, which included permission to dismiss or discharge personal debt.

Personal bankruptcies have been filed at record-setting paces during the 1990s and into the 21st century. During this period of time, Oklahoma has ranked in the top 10 in the number of bankruptcies per capita.

While you may not be able to control or prevent everything that happens, you can decrease the potential for filing bankruptcy by making good choices. These include establishing and following a budget, making a monthly commitment to savings, and spending less than you earn.

In the box below, summarize three things you have learned about your rights and responsibilities if you have too much debt and cannot make the payments.

1.

2.

3.

COMPLETE: You Be the Judge – Activity 13.1.1

Review student answers before continuing with this section.

Oklahoma Bankruptcies

In the year ending September 2007, there were over 775,000 personal bankruptcy filings in the United States. About 8,600 of them were in Oklahoma. Approximately three out of four filings in Oklahoma were Chapter 7.

Source: www.uscourts.gov

After Bankruptcy

Bankruptcy has both costs and benefits. It provides immediate relief from creditors who are calling you asking for payments, and it reduces the stress of trying to manage everything by yourself. Bankruptcy also allows you the opportunity to start fresh with little or no debt.

However, the decision to file also has substantial costs. Because bankruptcy remains on your credit file for ten years, you will probably be a high risk for most lenders. Having bankruptcy in your credit history will lower your credit score, resulting in much higher interest rates when you attempt to borrow money. Bankruptcy may also prevent you from buying a home or getting the job of your choice. Also, lenders and future employers may consider you a high risk and not feel comfortable with your level of personal responsibility.

TEACHING IDEA

For information on bankruptcy statistics, go to www.uscourts.gov/bnkrpctystats/**statistics**.htm or www.abiworld.org. ABI World provides additional information on U.S. bankruptcy trends.

Even with bankruptcy, not all debt is eliminated. For example, student loans and income taxes still have to be paid.

In addition, there is a financial cost to filing bankruptcy. As part of the process, you are required to pay a filing fee to the court and your attorney fees. You may also have to take time off from work to meet with attorneys, attend counseling sessions, and appear in court. Those requirements add additional costs to your decision to file bankruptcy.

Bankruptcy Fraud

Making false statements or failing to accurately report all information during the bankruptcy process is a crime. If you decide to file bankruptcy, it is important to follow the rules or face serious charges. In addition, your petition to file bankruptcy will be denied and you will be required to repay all of your debt.

Societal Costs

Bankruptcy also has a cost to society. Tax dollars spent on bankruptcy courts and the people who work there cannot be spent on other public goods and services. In addition, creditors must employ people to represent them in court — adding to their cost of doing business. And, because there are no “free rides,” someone has to pay

those costs. Creditors simply pass those costs on to other customers, meaning everyone pays higher interest rates to offset the cost when someone cannot pay.

Repairing Your Credit

You may have seen the ads on television, received them in your email, or heard them on radio: "Come see us to erase everything negative in your credit file and improve your credit score." Beware! Most of these advertisements are scams. Most are making promises they cannot keep. Spending money to have your credit repaired is money wasted. In reality, there is very little a company can do to improve your credit rating for you.

The best way to improve your credit score is to establish a budget and start paying your bills on time. If you continue that practice, your score will gradually increase, and you will restore a positive credit history.

Conclusion

Practicing good money management reduces the potential for dealing with high levels of debt. However, life events can disrupt your plans and pose serious debt problems that need immediate attention. Dealing with high levels of debt is stressful and can have a negative impact on you and your family. Knowing your options will help you find the best way to handle debt problems when you owe more than you can pay. Only time, effort and commitment to paying your bills on time will make a difference in your credit score once you have experienced credit problems.

What did you recommend for Montana and Carolina before reading this lesson? Did reading this lesson you change your mind?

So, what do you think they should do?

If you said Montana and Carolina need financial counseling, then you are correct. Managing debt is very stressful and is frequently a source of marital problems, suicide, and health-related issues.

Young people like Montana and Carolina are among the fastest growing segment of the population filing bankruptcy because of high debt levels. With counseling and changes in behavior, this young couple might be able to avoid becoming another statistic.

Name: _____ Class Period: _____

Managing High Levels of Debt
Review Lesson 13.1

Answer the following questions and give the completed lesson to your teacher to review.

1. Which one of the following is considered an option to bankruptcy?

    a. Stop payment on all bills.
    b. Hire a credit repair service.
    c. Get consumer credit counseling.
    d. Get additional credit to pay off your bills.

2. When you file bankruptcy,

    a. you seek legal protection from your creditors.
    b. your credit score increases because you have no debt.
    c. you are no longer responsible for paying any of your creditors.
    d. you have the right to determine which bills you will repay and which ones you will not repay.

3. Bankruptcy stays on your credit file for

    a. 10 years.
    b. 5 years.
    c. 7 years.
    d. 4 years.

4. Which of the following statements is TRUE?

    a. Only poor people file bankruptcy.
    b. People who file bankruptcy can never get credit again.
    c. People who file bankruptcy are deadbeats who do not want to pay their bills.
    d. People who file bankruptcy pay higher interest because they are higher risk to lenders.

Name: _____ Class Period: _____

You Be the Judge – Activity 13.1.1

Use the following information to determine whether or not the person should file for personal bankruptcy.

Sanya and Jay have been married for 20 years. Life was good until Jay was diagnosed with a serious illness that required him to quit working. Even though they both had good jobs, they had little or no savings because they spent all of their extra money traveling, making frequent trips to Europe and Hawaii. Shortly before Jay got sick, they bought two new cars, a new house and new furniture. This is the last month his company will pay his health insurance, and he has no disability benefits after six months. The medical bills are growing, and their income is almost half of what it used to be. What should they do?

File bankruptcy Get credit/financial counseling Get a home equity loan

Explain your answer_____

_____

Steve is a single dad with three children. His wife was unhappy with their marriage and filed for divorce about a year ago. She moved out of state to get a new job and start a new life. With three kids and limited income, Steve's bills are mounting, and he continues getting further behind with his monthly payments. The bill collectors are calling and he is not sure what to do. What would you recommend to him?

File bankruptcy Get credit/financial counseling Get a debt consolidation loan

Explain your answer_____

_____

Heather enjoys spending money. She lives in a nice apartment, drives a sporty car, and wears fashionable clothes. She was so busy with her friends and having a good time that she forgot to pay her personal income taxes last year. But it really does not worry her; she knows she will take care of it someday. Heather thought she was a good money manager because she had several credit cards and always made the minimum payments on time each month. But with the student loan payments, the car payments, and all of those credit card bills, it is becoming harder each month to pay her bills. And now, the government wants its money. She had a friend who filed bankruptcy last year and thought she might do the same so she can erase her debt and start over. What would you recommend to her?

File bankruptcy Get credit/financial counseling Get a debt consolidation loan

Explain your answer_____

_____