



### The Basics

## The bankruptcy boom is back

A tough 2005 law initially slashed the number of filings, but the numbers are rising again because the root causes of unpaid debt were never addressed.

By [Liz Pulliam Weston](#)

Consumer bankruptcy filings continue to increase, with Chapter 7 liquidation filings rising 54% in the second quarter compared to the previous three months.

Consumer bankruptcies had plunged following the passage of a tough new bankruptcy law last year. By the second quarter, however, the pace of filings had picked up to 2,200 to 2,300 new filings per business day, more than four times the level in November 2005 after the bankruptcy law went into effect, according to Chris Lundquist, founder of [Lundquist Consulting](#), which tracks bankruptcy trends.

Individuals filed 85,449 Chapter 7 cases in the three months ended June 30 and 142,815 bankruptcy cases overall, a 39% increase from the previous quarter. (Most consumer bankruptcies are either Chapter 7s, which allow people to erase most of their unsecured debts, or Chapter 13s, which require that at least some of the debt be repaid over time.)

#### New bankruptcy filings

	1st quarter	2nd quarter	Change
Total cases	102,949	142,815	38.72%
Chapter 7	55,671	85,449	53.49%
Chapter 13	47,022	57,039	21.30%

Source: *Lundquist Consulting*

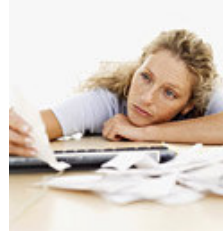
Currently, courts are reporting an average of 2,300 to 2,400 daily filings, Lundquist said. That's still significantly less than the record filing levels that drove passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. But it may indicate that the bankruptcy juggernaut was just stalled, not cured, by the new law.

### Flood hits credit counseling agencies

Meanwhile, the leading credit-counseling organization says bankruptcy reform is putting unprecedented strain on counselors' finances.

Bankruptcy filers are required to undergo credit counseling before they can proceed with their cases, and agencies affiliated with the [National Foundation for Credit Counseling](#) say such sessions now comprise one-third to one-half of their caseload, according to marketing director Bob Ensinger.

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But many debtors arrive at the counselors in such sorry shape that they can't pay the nominal fee the nonprofit agencies

impose. "We're running (these sessions) at a loss," Ensinger said.

Each pre-bankruptcy counseling session costs the agencies an average \$50.96, Ensinger said, but the average amount collected is just \$37.71. Losing \$13.25 on each session is bad enough, but the agencies complain that a larger than expected number of applicants is forcing them to redirect resources that might otherwise be used to help consumers who still have a fighting chance to pay their debts.

Surely, this is not what Congress had in mind.

Lawmakers wanted to stem a rising tide of filings, so they passed a law that can divert higher income filers into Chapter 13 repayment plans, rather than allowing them to file for a Chapter 7 liquidation of their debts. Critics said the bill unfairly punished consumers while putting few restrictions on irresponsible lenders.

### Fallout from reform

The reform law's unexpected -- and unpleasant -- consequences started before it even went into effect.

Consumers rushing to beat the Oct. 17 implementation flooded the court system, leading to long lines outside courthouses and unprecedented numbers of filings. More than 2 million consumer cases were filed in 2005, including 619,588 in October alone.

Consumers usually don't file bankruptcy on the spur of the moment. Typically, they struggle for years with their finances before giving in, Lundquist said. His research indicates that the "extra" filings last year represented many people who otherwise would not have filed for another 12 to 24 months.

All told, one in every 60 households filed a consumer bankruptcy in 2005, according to the [American Bankruptcy Institute](#). In 2004, one of every 79 households filed; by the first quarter of this year, the rate had plunged to 1 in 261.

Lenders knew many consumers would try to beat the deadline, but the actual size of the pre-implementation surge caught the industry by surprise. Many credit card issuers, in particular, wound up facing much larger losses than they expected, as I wrote in "[Bankruptcy law backfires on credit card issuers.](#)"

The reduction in filings after the law took effect -- first-quarter filings were down 73% from the same period a year ago, and second-quarter cases were 69% lower -- has been good news for those lenders. One measure of the industry's pain, [Fitch Ratings'](#) credit card index for charge-offs -- debt unpaid after six months -- plunged from a peak of 7.52% in November to 3.29% in February 2006.

### Ominous indicators

If charge-offs and other delinquencies start to tick up, however, we could see the pace of bankruptcy filings quickly follow.

Credit counselors are already reporting an increase in the number of debtors seeking help because of high gas prices and adjustable-rate mortgages that have reset at higher rates. Those debtors may well enter the bankruptcy pipeline in the next year or so.

Doing so will cost them more than in the days before bankruptcy reform. The average cost for a Chapter 7 filing used to be around \$1,000, said researcher David Skeel of the American Bankruptcy Institute. Now the going rate is about twice that. Chapter 13 filings tend to cost about 50% more.

"It is more costly to file and more of a hassle," Skeel said. "One of the great ironies (of bankruptcy) is that you can be too poor to file ... and there could be more people" in that predicament.

Lundquist thinks filings could eventually return to 90% of the old rate, although the pace will depend on the long-term effects of the new law.

"Are more people discouraged from filing bankruptcy? Will more file Chapter 13s instead of Chapter 7s? Will more people chose alternatives to bankruptcy?" Lundquist asked. "It's just too early to know."

### Same factors propelling bankruptcies

The factors that helped feed the bankruptcy boom of the past decade are certainly still in place. Those include:

An enormous expansion of credit by the lending industry, including to customers with shaky repayment histories and questionable ability to repay. The amount of outstanding credit card debt was more than quadrupled since 1990, to \$696.7 billion, according to [CardWeb.com](#).

A large segment of the public that's financially illiterate. Only one-third of adults in a recent poll had a good understanding of basic economic and personal-finance concepts, according to a [Harris Interactive](#) study prepared for the [National Council on Economic Education](#).

Interest rates with no caps. Many credit cards now come with penalty rates above 30% that can be triggered by a single late payment. Overextended consumers facing those kinds of finance charges can quickly find themselves unable to keep up with payments.

A growing number of people who are uninsured, or underinsured, against medical bills. The [Census Bureau](#) counts

45 million uninsured, and a recent [Commonwealth Fund](#) study found 41% of moderate- to middle-income adults did not have health insurance for at least part of 2005, up from 28% in 2001. A Harvard University study found medical bills were a factor in half of consumer bankruptcies.

Given these trends -- and Congress' unwillingness to tackle any of them -- any lull in filings may well be as fleeting as a teaser rate.

*Liz Pulliam Weston's column appears every Monday and Thursday, exclusively on MSN Money. She also answers reader questions in the [Your Money message board](#).*

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