TESTIMONY OF GEORGE WALLACE
BEFORE THE
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW
OF THE
COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES

Oversight Hearing on the
Implementation of the
"Bankruptcy Abuse Prevention and Consumer Protection Act of 2005"

July 26, 2005

Good morning, Chairman Cannon, Ranking Member Watt, and Members of the Subcommittee. My name is George Wallace and it is my pleasure to appear before you to discuss the important topic of implementing the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" (the "Act"). I am testifying on behalf of the Coalition for the Implementation of Bankruptcy Reform (the "Coalition"), which is comprised of major trade associations and companies that represent the full range of consumer credit businesses interested in bankruptcy reform.

The Coalition is fully committed to working constructively with all interested parties to ensure that the Act is implemented as Congress intended. Our most important objective is to ensure that an improved bankruptcy process enables consumers to fully and efficiently obtain bankruptcy relief. At the same time, this improved process should afford a meaningful opportunity for consumers who can resolve their financial difficulties through counseling or other means to do so.

The Act represents the most important set of changes to the Bankruptcy Code since 1978 when Congress enacted the Bankruptcy Reform Act of 1978. It realigns commercial and consumer bankruptcy policy in a number of ways, including introducing a formal means test and credit counseling requirements into consumer bankruptcies, and imposing significant reforms in the areas of health care providers, retailers, and small businesses. Important new provisions deal with cross border insolvencies, financial contracts, and family farmers and fishermen, as well as with misbehavior of corporate officers on the eve of bankruptcy.

My remarks today are focused upon implementation of the consumer bankruptcy provisions of the Act. Although the Act brings much needed fundamental change to this area, it must be appropriately and efficiently implemented to fully accomplish its underlying goals. Below I discuss some of the more significant elements of the consumer bankruptcy implementation process.

Consumer Credit Counseling

During the 9 years of deliberations on the Act, it became all too clear that many consumers file for bankruptcy without ever realizing that it is possible to resolve their financial difficulties in more constructive ways. The Act seeks to address this issue by requiring consumers to obtain basic education before filing for bankruptcy. In particular, Section 106 of the Act requires consumers to obtain a briefing that outlines the opportunities for available credit counseling and assists them in performing a related budget analysis. The briefing must be obtained from a "non-profit budget and credit counseling agency" approved by the United States Trustee (or bankruptcy administrator if applicable). This is one of the most important consumer benefits included in the Act. It creates an opportunity for consumers to avoid filing for bankruptcy if their financial condition enables them to do so. In order to ensure that this provision is effective, it is imperative that only counseling agencies of the highest quality are approved by the U.S. Trustee.

On June 30, 2005 the U.S. Trustee Program took an important step to achieve this objective when it announced that it would begin accepting credit counseling applications. The application and accompanying materials published by the U.S. Trustee go a long way towards ensuring that the congressional intent of Section 106 is properly implemented. The U.S. Trustee is to be strongly commended for its efforts. We urge, however, that the U.S. Trustee consider modifications to its application package in two respects. First, we are concerned that the bonding requirements included in the application materials may be excessive given the limited resources of many non-profit counseling agencies. In some cases, these requirements could divert tens of thousands of dollars of resources that non-profit counseling agencies would otherwise be able to devote to counseling efforts. We understand that the U.S. Trustee has acknowledged this issue and is considering ways to address it. One possible solution would be to impose a cap on the bonding requirements of an individual credit counselor based on a variety of factors including the resources of the counselor and other bonds it already has in place, for example, under state law requirements.

Second, the application materials appropriately indicate that counselors must ensure that they properly identify consumers when they seek the counseling mandated under Section 106. This is an important provision, and we commend the U.S. Trustee for including it in the application materials. We note, however, that many counselors are seeking guidance on how to obtain proper identification of consumers particularly when the counseling is conducted remotely, such as by Internet or phone. One possible solution to this issue would be to provide guidance that counselors will be deemed to have properly identified a consumer who appears for counseling in person by checking a government-issued I.D. presented by the consumer, such as a driver's license or passport. For consumers who obtain counseling remotely, a consumer should be deemed to be adequately identified if the counselor is able to verify the consumer's identity information by comparing it to a consumer report from a consumer reporting agency or similar document obtained from other verification sources.

The requirements of Section 106 do not apply in any district where the U.S. Trustee determines that approved non-profit budget and credit counseling agencies are not available to individuals in that district. We recognize that some parties may be concerned that counseling services may not be available in some areas when the requirements take effect on

October 17, 2005. Non-profit counseling agencies across the country are working diligently to ensure that they have adequate capacity to provide these important services when required to do so. We are confident that the non-profit counseling agencies will be able to meet this challenge, and we urge the U.S. Trustee to continue its efforts to ensure that only top-quality counselors are approved.

Needs-Based Bankruptcy

Another essential component of the reforms contained in the Act is found in Title I which establishes a new "needs-based" bankruptcy process. In particular, Section 102 of the Act creates a presumption that a Chapter 7 proceeding should be dismissed for "abuse" if over 5 years, the debtor has the ability to repay the lesser of: (i) $10,000; or (ii) 25% of the debtor's total non-priority, unsecured claims (but which must be at least $6,000). The debtor's ability to repay is based on a relatively simple "means test" calculation which takes the debtor's average income over the last 6 months, and deducts certain allowable expenses set by the IRS, as well as categories of the debtor's actual expenses and actual payments for secured debts and priority debts. Congress carefully crafted the means test to ensure that it provides appropriate flexibility for debtors who have "special circumstances" that "justify" adjustments to income or expenses for which there is "no reasonable alternative."

Congress designed the needs-based process so that it could be implemented efficiently without imposing undue burdens on those that administer the bankruptcy process. Under the needs-based system, each debtor is required to include the means test calculations in the bankruptcy schedules filed at the beginning of the bankruptcy case. The debtor also is required to provide his or her paystubs covering the 60 days prior to filing and the debtor's most recent federal tax return. Based on the information filed with the court, the clerk must notify all creditors within 10 days of filing if the information filed indicates the presumption of abuse is triggered. In order for the clerks to be able to execute their duties efficiently, it is imperative that the needs-based bankruptcy forms be properly crafted. The forms should be simple and easy for consumers to understand and should provide a clear indication to the clerks as to whether the presumption of repayment capacity is triggered.

Properly crafted forms also will assist the trustees and bankruptcy administrators in fulfilling their duties. When a consumer files for bankruptcy, the trustee or bankruptcy administrator is required to review the schedules and, 10 days after the first meeting of creditors, file a report with the court as to whether the case would be presumed to be an abuse because the debtor has filed in Chapter 7 but has the capacity to repay. The court must provide a copy of that report to all creditors within 5 days. In those cases where the application of the means test indicates a presumption of abuse (and the debtor's income is above the applicable state median income level), the trustee or administrator has 30 days to file with the court either a motion to dismiss the case or a statement as to why no motion is being filed. Based on the carefully crafted provisions enacted by Congress, it would be anticipated that trustees and bankruptcy administrators will file such a motion in the overwhelming majority of cases where the presumption of abuse is triggered. Guidance from the Department of Justice to the trustees may be helpful in clarifying this point. In particular, use of any additional tolerances above the means test enacted by Congress should be avoided. In this regard, it is reported that in prior Administrations, there was discussion about requiring the debtor to have an additional 10 or 15%

repayment capacity above that enacted by Congress before a trustee would bring a motion based on the means test. Such deviations from the clearly defined means test enacted by Congress are unnecessary because Congress already built into the needs-based test sufficient flexibility in the repayment thresholds and through the "special circumstances" provisions noted above.

Audits

During the deliberations on the Act, there was wide agreement that much of the information filed in individual bankruptcy cases is largely unreliable notwithstanding existing penalties against filing false information in a bankruptcy case. In order to address this issue, Section 603 of the Act requires the establishment of procedures "to determine the accuracy, veracity, and completeness of petitions, schedules, and other information that the debtor is required to provide in individual bankruptcy cases." These procedures must be established by the U.S. Attorney General (in judicial districts served by the United States Trustees) and the Judicial Conference of the United States (in judicial districts served by bankruptcy administrators). The procedures must include audits in accordance with generally accepted auditing standards and the audits must be performed by independent certified public accountants or independent licensed public accountants. The Attorney General and Judicial Conference, however, may develop alternative auditing standards within the 2 years after the date of enactment of the Act.

The procedures required by Section 603 must establish a method of selecting appropriate qualified persons to enter into contracts to perform the audits. In addition, the procedures must establish a method of randomly selecting at least 1 out of every 250 cases to be audited in each federal judicial district. The procedures also must require audits of schedules of income and expenses that reflect greater than average variances from the statistical norm of the district in which the schedules were filed. Finally, the procedures must provide for reports at least annually concerning the aggregate results of the audits, including the percentage of cases, by district, in which a material misstatement of income or expenditures is reported.

These audit provisions are an extremely important part of proper implementation of the Act because the information filed by individuals in a bankruptcy case is essential for the proper working of the new bankruptcy process. Without appropriate audits, the lack of reliability Congress found to exist will continue unabated.

Information Filed With Bankruptcy Case

As part of the efforts to address the unreliability of information filed in bankruptcy cases, the Act requires that individual debtors must file tax returns and paystubs in Chapter 7 and Chapter 13 cases. Congress recognized the importance of this information, particularly in connection with administration of the controls on abusive use of Chapter 7, including the needs-based bankruptcy test. Under the Act, the paystubs must be filed with other materials as part of the bankruptcy filing, such as the list of creditors, and must be provided to parties in interest to the case. Debtors also must file their most recent federal tax return and the debtor or trustee must provide a copy of such return to the debtor's creditors upon request. In order to ensure that congressional intent is implemented, the trustees must make sure that

procedures are in place to ensure that creditors in the case are able to access the tax return and other information efficiently.

Reaffirmation Agreements

The extensive hearing record on the Act reflects that many consumers who file for bankruptcy have a strong desire to reaffirm some of their debts. Many bankruptcy judges, however, disfavor reaffirmation agreements and have adopted their own reaffirmation rules and have made it difficult for debtors to reaffirm.

To address this issue, the Act includes new provisions clearly defining and standardizing the process for reaffirming a debt. While the Act sets out verbatim the specific disclosures that must be made in connection with a reaffirmation agreement, it would be very helpful in ensuring uniform nationwide implementation if the Administrative Office of United States Courts which now provides a non-mandatory form for reaffirmations would promptly revise and publish a new form faithfully following the new statutory requirements.[1]

Improve Bankruptcy Statistics

Section 601 of the Act requires the Clerk of the Court to collect statistics regarding debtors or individuals with consumer debts seeking relief under Chapters 7, 11, and 13. Those statistics must include the total assets and liabilities of consumer debtors, the income and expense figures for such debtors, and the aggregate amount of debt discharged for consumer debtors.

Under Section 602 of the Act, the Attorney General must, within a reasonable time after the effective date (18 months after enactment of the Act), issue rules requiring uniform forms for final reports by trustees in cases under Chapters 7, 12, and 13. Each report must be designed to facilitate compilation of data and maximum possible access to the public. The reports must include information to evaluate the efficiency and practicality of the bankruptcy system.

Conclusion

I have highlighted some of the most important implementation tasks, but I have hardly been exhaustive. What is important to understand is that the Act's reforms require cooperation by several separate governmental and quasi-governmental agencies if the legislation's goals are to be promptly realized. The Bankruptcy Rules must be revised in several respects, and since the formal process to do so takes some time, uniform interim rules that can be adopted by each local bankruptcy court should be proposed. Forms and procedures must be developed. Issues, as they arise, must be resolved. The bankruptcy judges, bankruptcy court clerks, United States Trustees, bankruptcy administrators, Chapter 7 and Chapter 13 trustees, U.S. attorneys in each district, as well as the Federal Reserve Board, the Government Accountability Office, Internal Revenue Service, and the Administrative Office of United States Courts all have important functions to perform, either in cheerfully making the new system work,

[1] There should be two different versions of the form to reflect the different treatment for credit unions as compared to other types of creditors.

or examining how well it does work. We appreciate the interest the Subcommittee has shown in overseeing this process, and encouraging the involved parties to work together in good faith to implement the legislation.

I would like to thank the Subcommittee for the opportunity to appear before you today to discuss this important topic. The Coalition is fully committed to working with the Subcommittee and other interested parties to ensure that the Act is implemented efficiently and fairly. I would be happy to answer any questions you may have.