

# DEBT / BANKRUPTCY

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## Secured Debt

- A debt on which a creditor has a lien. The creditor can institute a foreclosure or repossession to take the property identified by the lien, called the collateral, to satisfy the debt if you default.

## Examples of Secured Debt

- Home mortgage
- Car Loans
- Store Purchases

## Home Mortgage

- A home mortgage is one of the most obvious examples of secured debt. A lot of home financing is done under a Deed of Trust which provides a quick and inexpensive way for the lender to take the home from you if you default on your mortgage payments.
- Your house is considered collateral towards debt. If you default on payment, the bank seizes your house, sells it and uses the proceeds to pay back the debt (also known as foreclosure).

## Car Loans

- When you buy a car, the lender will put a lien on your car. Liens on vehicles are usually shown on the title to the vehicle. This lien allows the creditor to repossess the car anytime you default in your payments.

## Store Purchases

- When you purchase something at a store it is very common for the store to retain a security interest in the item you are purchasing. Installment payments were established to help consumers purchase goods. As a result, Sears may be able to take the bed, television, or even the hammer you bought from them if you don't make your payments. The basis for this security interest is the agreement you signed when you first opened the account.

## Unsecured Debt

- A debt that is not tied to any item of property. A creditor doesn't have the right to grab property to satisfy the debt if you default. The creditor's only remedy is to sue you and get a judgment.

## Examples of Unsecured Debt

- Credit Cards
  - Example: Visa, Discover, etc.
- Gas Cards
  - Example: Exxon, Shell, etc.
- Store Charge Cards
  - Example: Department stores, Wal-Mart, etc.
- Payday Loans
  - Example: Check cashing advances
- Personal Loans
  - Bank unsecured loans
- Medical Bills

## Credit Cards

- Credit Card Debt results when a client of a credit card company purchases an item or service through the card system.
- The results of not paying this debt on time are that the company will charge a late payment penalty (generally in the US from \$10 to \$40) and report the late payment to credit rating agencies.
- Universal Default- Other credit card companies charging for late payments

## Payday Loans

- A payday loan or paycheck advance is a small, short-term loan (typically up to \$1,500) that is intended to bridge the borrower's cash flow gap between paydays. Payday loans are also sometimes referred to as cash advances, though that term can also refer to cash provided against a prearranged line of credit such as a credit card.

## Unsecured vs. Secured

- Unsecured debt is negotiable because there is nothing being held as collateral for a penalty if the debt goes unpaid or is settled. Instead, interest is accumulated on the balance left to pay as an incentive to pay the bill.
- Secured debt is non-negotiable. This is an amount of money borrowed for something specific that is also used as collateral. If the debt amount goes unpaid, the object used for collateral could be retracted.

## History of Bankruptcy

- Overview
  - Timeline
  - Definitions
  - Contributing Factors
  - Statistics
    - United States
    - Utah

## Europe

- Bankruptcy
  - “on the road”
- 1300 Italy
  - Root of word comes from the Italian word for broken bench “banca rotta”. When a merchant didn’t pay his bills his marketplace bench was broken and assets sold.
- 1570 England
  - only creditors and merchants could be considered to file for bankruptcy
- 1604 England
  - penalties increases such from a debtor’s ear to be cut off to the death penalty.

## The United States

- 1800- U.S. passed law similar to the version of the British law, but no death penalty
- 1898- New law becomes the basis of current law. Voluntary bankruptcy & discharge of debt
- 1938- Chapter 13 bankruptcy option was established
- 1977- Lawyers are allowed to advertise
- 1978- U.S. Supreme Court removes caps on interest rates
- 1984- Bankruptcy law is amended to prevent certain types of debt from being discharged

## The Major Types of Bankruptcy

- Chapter 7
  - Eliminates all debts except some taxes and alimony payments and child support
  - Also called straight bankruptcy
- Chapter 13
  - Eliminates certain types of debt and restructures the remaining debt
  - Court ordered repayment plan

## Profiles

What are the demographics of the average bankruptcy filer?

## 1997 Profile

- The typical family filing for bankruptcy in 1997 owed more than one and a half times its annual income in short-term, high-interest debt. A family earning \$24,000 had an average of \$36,000 in credit card and similar debt.

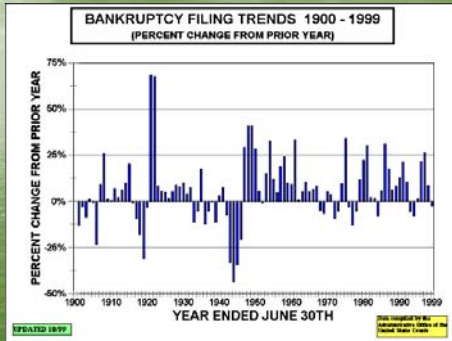
Federal Reserve (1997)

## Profiles of Bankruptcy in 2000

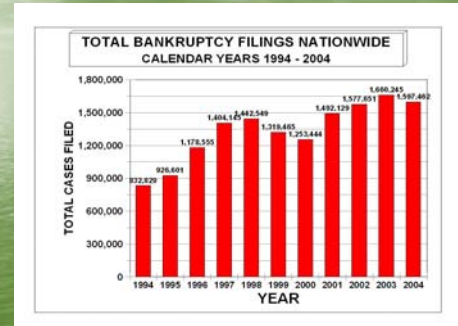
- Average age: 38;
- 44% of filers are couples;
- 30% are women filing alone;
- 26% are men filing alone;
- Slightly better educated than the general population;
- Two out of three have lost a job;
- Half have experienced a serious health problem;
- Fewer than 9% have not suffered a job loss, medical event or divorce;
- Highest bankruptcy rates: Tennessee, Utah, Georgia, Alabama.

Source: *The Fragile Middle Class: Americans in Debt, 2000*  
Elizabeth Warren, Harvard Law School; Smith Business Solutions

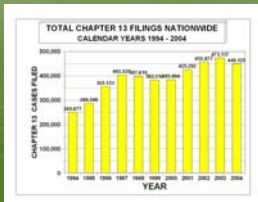
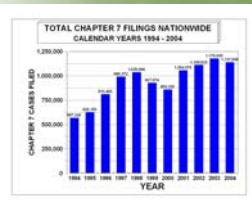
## United States Stats.



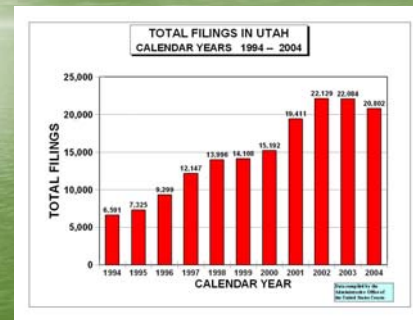
## United States (cont.)



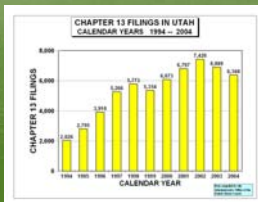
## United States (cont.)



## What about Utah?



## Utah (cont.)

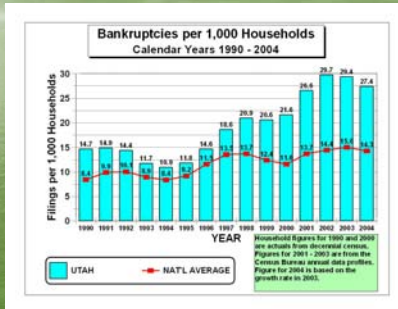


## The History of Utah's Bankruptcy Rates

- Utah has consistently ranked in the top quarter states with high bankruptcy rates since the 1960's
- During the 1980's, a wave of bankruptcy filings pushed Utah into the top 10 "worst" states.
- Since 1998, Utah has been in the top 5 "worst" states for bankruptcy.
- In 2002 and 2003, Utah became #1 with the highest household bankruptcy rates.

• Utah Foundation Press Release December 15<sup>th</sup>, 2004

## Utah (cont.)



## Bankruptcies

Total bankruptcies during the 12-month period ending March 31, 2004

NATIONAL AVERAGE: **72.8** HOUSEHOLDS PER FILING

TOP 5		
RANK*	STATE	HOUSEHOLDS PER FILING
1	<b>UTAH</b>	36.5
2	Tennessee	38.7
3	Georgia	42.4
4	Nevada	42.9
5	Alabama	47.2

BOTTOM 5		
RANK*	STATE	HOUSEHOLDS PER FILING
47	New Hampshire	122.3
48	North Dakota	125.8
49	Massachusetts	144.3
50	Vermont	156.2
51	Alaska	171.2

\*Includes the District of Columbia  
SOURCE: American Bankruptcy Institute

## The American Bankruptcy Institute's 1<sup>st</sup> quarter statistics for 2006

- Top 3 states for total # of filers
  - 1- Georgia- 8,643
  - 2- Texas- 7,225
  - 3- Michigan- 6,687
- 30- Utah- 1,072



## Some Theories on Utah's High Bankruptcy Rate

1. High home prices relative to income
2. Increasing credit card debt
3. Declining personal savings
4. Irresponsible spending habits
5. Decline in the stigma that is associated with bankruptcy
6. Repeat filings (Chapter 13 to Chapter 7)

\* Utah Foundation Press Release December 15<sup>th</sup>, 2004

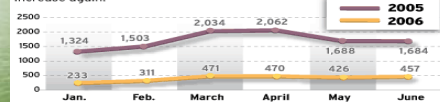


On March 11, 2005, congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The new bankruptcy law went into effect on October 17<sup>th</sup>, 2005.

## Where are we now? Bankruptcy filers in 2005 and 2006

### Utah bankruptcies

The number of Utahns filing for bankruptcy during the first half of this year was down significantly from the first half of 2005. While that decline is the result of last year's revamp of the nation's bankruptcy laws, some observers expect bankruptcy numbers eventually to increase again.



2006 filing breakdown				
	CHAPTER 7	CHAPTER 13	CHAPTER 11	CHAPTER 12
Jan.	103	128	1	2
Feb.	180	130	1	1
March	329	142	1	1
April	307	158	1	5
May	272	152	1	1
June	310	145	1	2

Source: U.S. Bankruptcy Court for Utah, ANTV LAWYERS/The Salt Lake Tribune

## Here are Some Major Changes You Should Know About

### 1- Credit Counseling

- Before filing, debtors must take a credit counseling course which allows debtors know if they "qualify" for bankruptcy
- Gives counseling to those filing for bankruptcy
- Must complete prior to 341 hearing



## Major Changes (cont.)

### 2- Median Household Income Test is used to consider more Chapter 13 filers

- To calculate their "Current monthly income", the debtors income over the past 6 months prior to filing is taken into consideration
- If income is less than or equal to the median household income, a debtor may file for a chapter 7. If income is greater than median household income, the filer must pass the "means test".

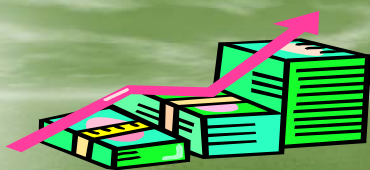
## Major Changes (cont.)

- 3- Some chapter 13 filers will need to live on less
- 4- Property must be valued at replacement costs
- 5- Much more expensive for filers
  - Expensive and time consuming for lawyers, increases attorney fees

## Major Changes (cont.)

### 6- End of filing money management class

- Class is established to teach consumers the importance of debt and money management
- Filers must attend this class to complete their bankruptcy



## What Some are Saying About the New Bankruptcy Laws

### Anne House, Director USU Debt Education Program

- Regarding credit counseling: "I notice the change in people from when they walk into the door, to the minute they leave. Some walk in bored out of their mind, but leave educated and involved. It is difficult to gauge if the money management classes are effective. A long term study needs to be done to see if the bankruptcy filers are staying out of debt, or becoming revolving debtors."



## What Some are Saying About the New Bankruptcy Laws

- Joel Marker (Chapter 7 Trustee)
  - Much more expensive for routine cases to be filed. The cost of the new bankruptcy law is being felt by the consumers. The new laws are making it difficult for filers because of the economic difficulties they are already facing.
  - Fees have significantly increased for filers who are below the median income test

## Heather Haycock: RC Willey Bankruptcy Representative

- “Chapter 13’s are much better for RC Willey because of the consistent payments that are being made”.
- “341 hearings are effective for RC Willey because it helps us to understand a clear picture of the situation. We are protecting our assets”.
- “RC Willey wants to keep within the boundaries of bankruptcy because of the higher amount of financial involvement. RC Willey wants to be ahead of the game. In order for the filings to be complete, we must be present at the 341 hearings”.

## Dr. Jean Lown: Professor USU

- Prior to the new bankruptcy law, only about 25% of people who filed for a chapter 13 actually completed.
- 3 reasons behind the high bankruptcy rates
  - Lenders will borrow to anyone
  - Fed increasing the interest rates (17 times in a row which hurts people with adjustable rate mortgages and car loans)
  - Rise in consumer prices (housing, gas, and interest rates)

## Purpose of the New Policy

- The intentions of the new bankruptcy law is to qualify more debtors for chapter 13’s, which allows more debtors to keep their consumer goods
- Decrease the amount of filers in general
- Provide education regarding money management and financial stability before and after filing for bankruptcy

## Reasons why this policy would achieve its purpose

- The new bankruptcy law was made to help curve the amount of bankruptcy’s filed in the US every year by setting up new strict requirements that you have to meet in order to qualify.

## Possible side effects of the policy

- **Making it more difficult for people who really need to file**
  - the new bill sets up rigid means test and if you don’t qualify then you will not be able to receive relief. Also if you are in the grey area of the law you can have your case challenged causing you to spend a lot of money on attorney’s in order to have our debts discharged.
- **Endangers child support**
  - the new bill will make it harder to recover child support. If the courts determine that the secured debts are more important than child support you could find the custodial parent will have to work with creditors to get at the debtors limited disposable income.
- **Rewards an industry**
  - The new bill also rewards credit card companies and other lenders for giving people large credit limits when they know that they can possibly pay back the amounts borrowed to them.

## Possible Side Effects of the Policy

- Makes chapter 13 repayment plans more difficult to manage – because of the strict means test it does make it harder for people to pay back their debts. The reason for this being that the new law only allows you certain amount for your monthly expenses and if you go over that amount you could still be required to pay back a larger amount of money than you have available each month.
- Makes it easier for a landlord to evict a tenant who files bankruptcy.

## Conclusion

Careful with your money  
Save for future events  
Be all you can be!!!!!!