Testimony of

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SUBMISSION OF DAVID C. JONES
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UNITED STATES SENATE JUDICIARY COMMITTEE
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS
Hearing On The
ONE-YEAR ANNIVERSARY OF THE
BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT
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Mr. Chairman and members of the Subcommittee, the Association of Independent Consumer Credit Counseling Agencies (AICCCA) appreciates the opportunity to address the current issues and future viability of the pre-bankruptcy credit counseling and pre-discharge financial education provisions of BAPCPA. AICCCA members currently provide counseling and education to millions of U.S. consumers and serve over 750,000 clients repaying their debts through legitimate Debt Management Plans. Together, these agencies annually return over $3.2 billion in consumer payments to the nation's creditors while providing consumers with a financial restructuring option outside of the bankruptcy system. In addition, we have counseled over 200,000 consumers entering the bankruptcy system since October of 2005.

AICCCA is pleased to provide input to the Subcommittee as it considers the effectiveness and future viability of pre-bankruptcy credit counseling, pre-discharge education. We commend Chairman Sessions for his authorship of these provisions, which seek to assure that debtors are fully informed of all their viable options for addressing financial distress before they file for bankruptcy, and that they emerge from the bankruptcy process with the basic education and budgeting tools that can minimize any future need for another bankruptcy filing. While we have some concerns about the process to date, we commend the Executive Office for US Trustees (EOUST) for its diligent attention to the implementation of these provisions and the Internal Revenue Service for its continued oversight of the credit counseling industry. We believe that consumers have benefited along with the nation's financial system.

The main points of my testimony are:
? There are more than adequate approved credit counseling agency resources available to provide pre-bankruptcy counseling at current filing levels but a focused effort would be advisable to assure that this remains the case as filings increase over time.
? Non-profit credit counseling agencies are currently providing pre-bankruptcy counseling at an

overall financial loss and this situation must be addressed to help assure their continued voluntary participation; guidance from the EOUST regarding a clear standard for determining a debtor's ability to pay would be one welcome step toward that goal.
? The EOUST should also clarify what information credit counseling agencies may provide to debtors about the bankruptcy system without impermissibly providing legal advice, and should also clarify permissible relationships between counseling agencies and debtor attorneys.
? The EOUST should not remove an agency from its approved list solely because its tax-exempt status is in question, and Congress needs to do more to assure that IRS field personnel are correctly implementing and communicating the current legal criteria for credit counseling agencies to achieve and retain Section 501(c)(3) tax-exempt status.
? The EOUST needs to provide guidance to assist in establishing debt settlement plans as a sanctioned non-bankruptcy alternative for those debtors who cannot fully fund a traditional debt management plan.

Our comprehensive comments further address these operational areas.

1. Bankruptcy Filing Levels and the Adequacy of Credit Counseling Resources

As you know, bankruptcy filings have undergone an extraordinary decline in 2006. According to information released by the Administrative Office of U.S. Courts on August 28th, filings in the second quarter of 2006 totaled 156,000, following up on first quarter filings of 117,000, for a total in the first half of 2006 of about 273,000. We do not have an explanation for the dramatic decline in filings, other than that we are certain that the necessity to obtain counseling from an approved Credit Counseling Agency (CCA) prior to filing and the modest cost of such counseling (waived or reduced for those debtors lacking ability to pay) cannot be a factor of any significance. Unless there is a very large increase in bankruptcy filings during the remainder of the year, total filings for 2006 are likely to be less than half of those for 2005, and could in fact be as many as one million cases less.

The present number of approved CCAs appears more than adequate to satisfy the need for pre-bankruptcy counseling at current filing levels. Even so, the credit counseling process demands a very personal approach with a distressed debtor. That process can only be effective when accomplished in a comprehensive face-to-face or telephone session. We do not believe that adequate counseling can be accomplished using the Internet alone. This consideration should be a major factor in the continuing implementation of BAPCPA and the EOUST's provider re-approval process.

We have serious concerns about the adequacy of counseling capacity should there be a significant upward spike in filings, especially if some currently approved agencies are not re-approved. A shortage of capacity in such circumstances could trigger the provisions of BAPCPA that provide for suspension of the counseling requirement in judicial districts lacking adequate capacity, and call into question the pre-bankruptcy counseling requirement unnecessarily. We believe strong efforts should be made to avoid such an outcome. Without some focused effort, there is a very real possibility that the number of participating CCAs will decline even as bankruptcy filings begin to accelerate.

2. The Need To Clarify "Ability To Pay"

Every CCA approved to provide pre-bankruptcy counseling must charge a "reasonable fee" for counseling services, must provide services "without regard to ability to pay that fee," and must provide to the EOUST its "criteria for providing services without a fee or at a reduced rate." AICCCA applauds these criteria, which are consistent with our own member accreditation standards.

Approved CCAs have, to date, been extremely cautious in assessing fees from debtors who claim they lack ability to pay. Yet approved CCAs have consistently been offering pre-bankruptcy counseling at a significant financial loss. All the information we have seen indicates that, for both AICCCA member and other approved agencies, the cost of providing a pre-bankruptcy counseling session in accord with EOUST criteria is about $50, while the average payment for such a session is about $32. Less than two percent of the present debtor population is even eligible to enter a Debt Management Plan (DMP), and many of those nonetheless choose to file bankruptcy. The opportunity so far for CCAs to offset the counseling loss with DMP income is negligible. This situation is simply not sustainable for non-profit entities that are already navigating severe fiscal constraints.

There are only two available remedies for this situation, absent external subsidy. The first is for the EOUST to clarify under what circumstances an approved CCA may refuse to provide counseling to an individual debtor, or refuse to provide a certificate of completion to a debtor who has received counseling, where the debtor's own financial information indicates that they indeed have an ability to pay a full or reduced fee. The second is to raise the average charge for a BAPCPA counseling session, which could well have the unfortunate result that some honest debtors would incur a higher fee to offset the refusal of another, perhaps better situated, debtor to pay the same fee.

Currently approved agencies will simply not be able to continue participation over the long term if the provision of BAPCPA counseling does not become at least a break-even financial proposition. This is especially true because the actual cost of completing an application to be an approved agency is, based upon feedback from AICCCA members, substantially more than the $500 estimate provided by the EOUST in response to Executive Order 12866, and is accompanied by substantial additional costs for surety bonding as well as employee fidelity insurance.

3. The Question of What Constitutes Legal Advice

As noted earlier, bankruptcy filings have fallen by two-thirds compared to one year ago -- which means that the average debtor attorney is seeing two-thirds fewer prospective clients than one year ago. The debtor bar has made clear that it strongly opposed BAPCPA while it received Congressional consideration, and has already brought suit in multiple districts to seek judicial determination that its debt relief agency provision violates the Constitution.

The debtor bar has also made clear that it opposes, and resents, BAPCPA's pre-bankruptcy counseling requirement. While only about one percent of the current pre-bankruptcy counseled population is choosing an alternative to bankruptcy, it is quite possible that this percentage will

grow significantly when bankruptcy filings increase and the debtor financial profile begins to include greater numbers of higher income debtors. AICCCA takes strong issue with the view of the debtor bar that the current low conversion rate of counseled debtors to a DMP or other alternative to bankruptcy should be taken as evidence that the requirement is not worthwhile. To the contrary, the large majority of individuals counseled by AICCCA member agencies have indicated that they found the budget analysis and other aspects of the counseling session to be quite useful. Indeed, we would urge Congress and the EOUST , as well as the lending community, to consider what steps could better encourage counseling to be undertaken sooner. If we were seeing financially troubled individuals before their problems had grown dire, and before they had consulted with and even paid a substantial retainer to a bankruptcy attorney, we would probably see greater use of the available alternatives to bankruptcy. We also expect that, as filing levels climb, a greater proportion of individuals with higher incomes will be considering bankruptcy and will find a DMP a viable option.

The debtor bar has made clear that it will respond to the perceived threat of credit counseling by a number of means. First, it will look for opportunities to allege that a particular approved CCA is "practicing law without a license" by providing basic bankruptcy information as part of the counseling process. Second, it will intervene in the counseling relationship by intrusively monitoring it. Third, it will press for repeal of the credit counseling requirement at the earliest political opportunity.

The EOUST already requires that approved CCAs..."shall not, unless otherwise authorized by law, provide legal advice on any matter." It would be extremely helpful to the credit counseling industry if the EOUST would delineate the boundaries of what advice can be provided by an approved CCA to a counseling client regarding the availability and consequences of bankruptcy without crossing the line to providing "legal advice." It would seem obvious that a counselor assisting a financially troubled debtor needs to be able to advise that individual that bankruptcy is one available option, that bankruptcy may offer either liquidation or partial repayment of debts depending on circumstances, and that a bankruptcy will remain on the credit report for a decade. These factual matters can be readily distinguished from the giving of advice regarding whether the debtor should file for bankruptcy, what Chapter of the Bankruptcy Code would be most advantageous and appropriate, and how the court would likely treat the bankruptcy petition.

BAPCPA's legislative history supports the view that Congress intended to ensure that debtors receive informed and objective advice from two separate sources -- an approved CCA and an attorney. Assuming that the EOUST addresses the proper pre-bankruptcy roles of attorneys and CCAs in the more comprehensive regulations it will propose later this year, we would urge it to clarify the legal and ethical boundaries for interaction between these two professions, particularly as regards the referral of clients to a particular agency and the collection of fees on behalf of that agency by a debtor attorney. EOUST oversight can help assure that attorney-agency relationship remains at arms' length, and that the counseling provided by each agency is comprehensive and meaningful.

4. Agency Removal

The EOUST has proposed that, in certain circumstances, its decision to revoke an agency's approved status need not wait upon an agency's exhaustion of its opportunity for administrative

review but may be effected immediately by an interim directive. We hope that this short-circuiting of the administrative appeals process will be a rare exception, and take particularly strong exception to the EOUST's proposal that one factor supporting such an interim directive can be the revocation of the agency's tax-exempt status by the Internal Revenue Service.

BAPCPA is quite clear that, while non-profit status is required to become an approved CCA, tax-exempt status is not. Because tax-exempt status is not a statutory requirement, the EOUST should not deprive an approved CCA of its appeals right simply because it might lose or has lost that status. The EOUST already requires every approved CCA to complete and sign a tax waiver authorizing it to seek confidential information regarding the agency from the IRS, as well as to notify it immediately of the termination of that tax-exempt status by the IRS. Therefore, the EOUST already has access to any information developed by the IRS in the course of its audit of a particular agency. AICCCA believes that the EOUST should make its own independent judgment regarding a CCA's eligibility to provide pre-bankruptcy counseling, separate and apart from any IRS determination.

That the criteria for EOUST approval and tax-exempt status are separate and distinct has been made even clearer by IRS and Congressional actions this past year. In May, the IRS provided new guidance regarding the "methodology" analysis it would employ in its audits of credit counseling agencies. That guidance, while welcome, still leaves a great deal of subjective discretion to each IRS auditor. The credit counseling industry has noted that the actual exercise of that discretion has resulted so far in final and proposed revocations or terminations for one hundred percent of the CCAs where an audit has been concluded, and that the IRS has only approved 3 of 110 applications for tax-exempt status received from new CCAs as of May. If the EOUST tightly ties approved agency eligibility to tax-exempt status it may find that it has further diminished its ability to assure adequate long-term counseling resources.

We would also note that Congress recently enacted new statutory requirements for the achievement of tax-exempt status by CCAs as part of H.R. 4, the Pension Protection Act. Those statutory provisions provide welcome clarification of the structural and operational requirements for such status, and also make clear that the provision of DMPs is consistent with tax-exempt status so long as properly integrated with counseling and educational services, and so long as associated "fair share" income from creditors constitutes no more than fifty percent of an agency's revenues. We appreciate the efforts of Chairman Sessions, Finance Committee Chairman Grassley, and Senator Coleman to provide helpful clarification of Congressional intent regarding the impact of H.R. 4 on the credit counseling industry when that bill was debated on the Senate floor. Unfortunately, we are receiving reports that IRS field personnel are misinterpreting the effect of H.R. 4 and are taking negative actions based upon that misinformation. For example, an AICCCA member agency in the Midwest has been told by an IRS field agent that H.R. 4 prohibits any agency that offers a DMP from receiving or retaining Section 501c3 tax-exempt status. We are assisting that agency in attempting to correct this situation, and they are also working with the local office of their U.S. Senator. However, it remains unresolved, and we can only wonder how many other qualified CCAs are receiving adverse IRS treatment despite the Congressional intent evidenced in H.R. 4. We therefore urge the Subcommittee to communicate with IRS Commissioner Everson and to urge him to take

immediate steps to assure that IRS staff both understand and impart the correct interpretation of H.R. 4.

While the counseling industry hopes that the recent Congressional clarification contained in H.R. 4 will reduce future IRS revocations, we continue to face the possibility that many agencies will be operating as non-profit entities lacking Section 501c3 tax-exempt status. The EOUST should not foreclose the availability of their resources to serve consumers in this event when they have met all the statutory requirements of BAPCPA and its implementing regulations.

5. Debt Settlement Plans

Bankruptcy Code Section 502(k) allows the court, on a debtor's motion and after a hearing, to reduce a claim based wholly on unsecured and non-dischargeable consumer debt by up to twenty percent, if the creditor unreasonably refused to negotiate a reasonable alternative repayment schedule proposed in a timely manner by an EOUST-approved CCA that would have provided for repayment of at least 60 percent of the debt during the loan's repayment period or a reasonable extension thereof.

This new provision potentially provides approved CCAs with some ability to negotiate a debt settlement plan on behalf of a debtor who lacks the financial resources to complete a one hundred percent repayment Debt Management Plan. That option would provide a whole new class of debtors with a non-bankruptcy repayment option similar to a Chapter 13 filing. However, it also makes a future legal right of the debtor contingent upon the present action of the approved CCA, and thereby it creates some potential legal liability for CCAs as well as some ethical questions. For example, is an approved CCA compelled to attempt to negotiate a sixty percent repayment plan on behalf of a debtor who has the financial capacity to make full repayment or can the CCA exercise some discretion when a debtor requests such action?

Given the potential of new forms of Debt Settlement Plans to provide benefits to both debtors and creditors, as well as the new responsibility thrust upon CCAs by Section 502(k), AICCCA believes that the EOUST should address this topic when it publishes more comprehensive proposed regulations later this year.

Conclusion

Overall, AICCCA believes that BAPCPA-mandated credit counseling has been successful and has had a beneficial affect on bankruptcy petitioners by providing them with possible alternatives and improving their understanding of specific personal financial issues. Mandated pre-discharge education will further serve to extend this consumer benefit and end the tragic circumstance of debtors emerging from bankruptcy without the requisite budgeting tools to avoid it in the future.

AICCCA appreciates this opportunity to provide input to the Subcommittee on these matters. We also appreciate the continuing dedication of the EOUST to the proper implementation of the required credit counseling provisions of BAPCPA, as well as the efforts of the IRS to ensure that consumers are protected from the small minority of credit counseling agencies who seek to take undue advantage of tax-exempt status.

Thank you for letting us share AICCCA's views with you. I would be happy to answer any questions.