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# BANKRUPTCY REFORM

## Value of Credit Counseling Requirement Is Not Clear

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Highlights of [GAO-07-778T](#), a testimony before the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, House of Representatives

## Why GAO Did This Study

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 requires individuals to receive credit counseling before filing for bankruptcy and to take a debtor education course before having debts discharged. Concerns were raised that the new requirements could expose consumers to abusive practices by credit counseling agencies or become barriers to filing for bankruptcy. This testimony is based on GAO's report issued last month, and addresses (1) the process of approving counseling and education providers, (2) the content and results of the counseling and education sessions, (3) the fees charged, and (4) the availability of and challenges to accessing services.

To address these issues, GAO reviewed Trustee Program data and application case files, and interviewed a wide range of individuals and groups involved in the bankruptcy process.

## What GAO Recommends

In its report, GAO recommended that the Department of Justice's U.S. Trustee Program, which is responsible for the new requirements, (1) develop the capability to track and analyze the outcomes of pre-filing credit counseling, and (2) issue formal guidance on what constitutes a client's "ability to pay." The Trustee Program agreed with GAO's recommendations.

[www.gao.gov/cgi-bin/getrpt?GAO-07-778T](http://www.gao.gov/cgi-bin/getrpt?GAO-07-778T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Yvonne D. Jones at (202) 512-8678 or [JonesY@gao.gov](mailto:JonesY@gao.gov).

# BANKRUPTCY REFORM

## Value of Credit Counseling Requirement Is Not Clear

### What GAO Found

The Trustee Program's process for approving credit counseling and debtor education providers was designed to help ensure that providers met statutory and program requirements and demonstrated evidence of proficiency, experience, and reputability. The Bankruptcy Act set certain standards for providers, and the program's July 2006 rule clarified these standards and formalized the application review process. As of October 2006, the Trustee Program had approved 153 credit counseling and 268 debtor education providers. These providers have had few formal complaints lodged against them, and federal and state law enforcement authorities with whom we spoke did not identify any recent enforcement actions against them under consumer protection laws. No provider approved by the Trustee Program has had its federal tax-exempt status revoked, although four providers' tax-exempt status was being examined by the Internal Revenue Service.

The content of the required credit counseling and debtor education sessions generally complied with statutory and program requirements. Participants in the bankruptcy process largely believed the education requirement—a general financial literacy course—to be beneficial. However, the value of the credit counseling requirement is not clear. The counseling was intended to help consumers make informed choices about bankruptcy and its alternatives. Yet anecdotal evidence suggests that by the time most clients receive the counseling, their financial situations are dire, leaving them with no viable alternative to bankruptcy. As a result, the requirement may often serve more as an administrative obstacle than as a timely presentation of meaningful options. Because no mechanism currently exists to track the outcomes of the counseling sessions, policymakers and program managers cannot fully assess how well the requirement is serving its intended purpose.

Providers typically charge about \$50 per session, and evidence suggests that fees are being waived as appropriate for clients unable to pay, as the Bankruptcy Act requires. Neither the statute nor Trustee Program guidance defines what constitutes "ability to pay," and policies vary among providers. Formal guidance on this issue would have several benefits, including ensuring compliance with a minimum standard for waiving fees.

The number of approved counseling and education providers appears sufficient to allow consumers to access these services in a timely manner. In-person sessions are not available in certain parts of the country, although the great majority of clients fulfill the requirements via telephone or Internet. The Trustee Program has efforts under way to help mitigate the challenges speakers of foreign languages can face in accessing services. Further, the bankruptcy courts have taken steps recently to help ensure that filers are aware of the potential consequences of filing for bankruptcy without the required counseling certificate.

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Madam Chairwoman and Members of the Subcommittee:

I appreciate the opportunity to participate in today's hearing on the impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Bankruptcy Act).<sup>1</sup> My statement today focuses on the credit counseling and debtor education requirements of the act and is based on our report that was released last month and prepared at the request of members of the Senate and House Judiciary Committees.<sup>2</sup>

Among other things, the Bankruptcy Act requires individuals to receive credit counseling before filing for bankruptcy and to take a debtor education course before having their debts discharged.<sup>3</sup> According to the legislative history of the act, a goal of the prefiling credit counseling requirement, which became effective in October 2005, is to ensure that consumers understand the options available to them and the consequences of filing for bankruptcy. However, the requirement raised a number of concerns, in part due to ongoing investigations of certain practices within the credit counseling industry, such as steering clients into inappropriate debt repayment plans. In addition, some members of Congress and others were concerned that the cost and availability of counseling and education services could serve as barriers to those seeking to file for bankruptcy. In response to these concerns, Congress required in the Bankruptcy Act that providers of credit counseling and debtor education courses meet certain criteria and obtain approval from the Department of Justice's U.S. Trustee Program (the Trustee Program).<sup>4</sup>

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<sup>1</sup>Pub. L. No. 109-8, 119 Stat. 23 (2005) (amending various sections of Title 11).

<sup>2</sup>GAO, *Bankruptcy Reform: Value of Credit Counseling Requirement Is Not Clear*, [GAO-07-203](#) (Washington, D.C.: Apr. 6, 2007).

<sup>3</sup>Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 106, 119 Stat. 37-42. Specifically, the statute requires (1) individuals to receive budget and credit counseling from an approved provider before filing a petition in bankruptcy and (2) bankruptcy petitioners to complete an instructional course on personal financial management in order to have their debts discharged. For the purposes of this statement, hereafter we refer to the prefiling budget and counseling requirement as the credit counseling requirement and the pre-discharge personal financial management course as the debtor education requirement.

<sup>4</sup>In this statement, we use the term provider to refer to a provider of prefiling credit counseling or pre-discharge debtor education that has been approved by the Trustee Program. References to the Trustee Program in this statement refer collectively to the U.S. Trustees and the Executive Office for U.S. Trustees.

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My statement discusses (1) the actions taken by the Trustee Program to approve credit counseling and debtor education providers; (2) the content and results of the counseling and education sessions; (3) the fees providers charge for counseling and education services, and the extent to which these services are provided regardless of clients' ability to pay; and (4) the availability of approved counseling and education services and the challenges consumers may face in receiving these services. Our report, and this testimony, are based on extensive audit work that included, among other things, a review of relevant policies, rules, guidance, and procedures; a case file review of a nonprobability sample of 43 providers approved by the Trustee Program; and interviews with representatives of relevant federal and state agencies, trade associations, consumer groups, and 10 approved providers of credit counseling or debtor education. We conducted our review from February 2006 through March 2007 in Washington, D.C., and Boston, Ma., in accordance with generally accepted government auditing standards.

In summary:

- We found the Trustee Program's process for approving credit counseling and debtor education providers was generally systematic and thorough, and designed to help ensure that the providers met statutory and program requirements and demonstrated evidence of proficiency, experience, and reputability. The Bankruptcy Act set certain standards for providers, and the program's July 2006 interim final rule clarified these standards and formalized the application review process. As of October 2006, the Trustee Program had approved 153 credit counseling and 268 debtor education providers. These providers have had few formal complaints lodged against them, and federal and state law enforcement authorities with whom we spoke did not identify any recent enforcement actions against them under consumer protection laws. As of the date of our report, no provider approved by the Trustee Program had had its federal tax-exempt status revoked. However, the Internal Revenue Service (IRS) was examining the tax-exempt status of four providers, and Trustee Program officials said that they were carefully monitoring the situation.
- The content of the required credit counseling and debtor education sessions generally complied with statutory and program requirements. Participants in the bankruptcy process largely believed the education requirement—a general financial literacy course—to be beneficial. In addition, we did not find evidence that pre-filing credit counseling agencies discouraged clients from filing for bankruptcy, and very few clients appeared to be entering into debt repayment plans administered by these agencies. However, the value of the credit counseling requirement is not

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clear. The counseling was intended to help consumers make informed choices about bankruptcy and its alternatives. Yet anecdotal evidence suggests that by the time most clients receive the counseling, their financial situations are dire, leaving them with no viable alternative to bankruptcy. As a result, the requirement may often serve more as an administrative obstacle than as a timely presentation of meaningful options. Because no mechanism currently exists to track the outcomes of counseling sessions—including how often they are followed by a bankruptcy filing—policymakers and program managers are unable to fully assess how well the requirement is serving its intended purpose. Our report recommends that the Trustee Program develop the capability to track and analyze the outcomes of prefiling credit counseling. In responding to a draft of our report, the Trustee Program said it concurred with this recommendation.

- Providers typically charge about \$50 or less per session, and industry observers and consumer advocates we spoke with generally considered this amount to be reasonable. Evidence suggests fees are being waived as appropriate for clients unable to pay, as the Bankruptcy Act requires. Neither the statute nor the Trustee Program guidance defines what constitutes “ability to pay,” and policies vary among providers. Our report recommends that the Trustee Program issue formal guidance on what constitutes ability to pay, so as to help reduce uncertainty among providers about when to waive fees and to provide a minimum benchmark for reducing or waiving fees. The program concurred with our recommendation.
- The number of approved counseling and education providers appears to be sufficient to allow consumers to access these services in a timely manner. Three large nationwide organizations represent about half of the market for both services. In-person counseling and education sessions are not available in certain parts of the country, but the great majority of clients seek to fulfill the requirements via telephone or Internet. The Trustee Program has efforts under way to help mitigate the challenges speakers of foreign languages can face in accessing services. Further, the bankruptcy courts have taken measures recently—on their filing forms and Web sites—to make the prefiling counseling requirement more conspicuous to filers who are not represented by an attorney.

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## Background

Federal courts have jurisdiction over bankruptcy cases and petitions can be filed in any one of the nation’s 94 judicial districts. The Trustee Program, a component of the Department of Justice, oversees the bankruptcy process for most of these districts and acts to ensure

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compliance with applicable laws and procedures.<sup>5</sup> The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was signed into law on April 20, 2005, and most of its provisions became effective on October 17, 2005. The act made substantial changes to the Bankruptcy Code, including adding new credit counseling and debtor education requirements, as follows:

- *Credit Counseling.* To be a “debtor” (that is, eligible to file for bankruptcy), an individual, except in limited circumstances, must receive from an approved provider, within 180 days preceding the date of filing a bankruptcy petition, (1) a briefing outlining the opportunities available for credit counseling and (2) assistance with performing a budget analysis. Individuals may satisfy the counseling requirement post-petition if the individual certifies the existence of exigent circumstances that merit a waiver.<sup>6</sup>
- *Debtor Education.* Prior to discharge of debts, Chapter 7 or Chapter 13 debtors must complete a personal financial management instructional course from an approved provider.<sup>7</sup>

The Bankruptcy Act designated the Trustee Program as responsible for the implementation of these requirements, including the development of rules and guidance and the certification of approved credit counseling and debtor education entities.

Credit counseling agencies generally work on behalf of their consumer clients, who are typically deeply in debt, to help them manage their existing financial problems and to teach them better financial management skills for the future. The Federal Trade Commission (FTC) and others have noted that many credit counseling agencies operate honestly and fairly and provide valuable services to financially distressed consumers. However, starting in the 1990s consumer complaints about some

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<sup>5</sup>Bankruptcy cases in Alabama and North Carolina are not under the jurisdiction of the Trustee Program and are administered instead by bankruptcy administrators in the judicial districts in those states.

<sup>6</sup>11 U.S.C. § 109(h).

<sup>7</sup>Consumers usually file for bankruptcy under one of two chapters of the Bankruptcy Code. Under Chapter 7, the debtor’s eligible assets are liquidated (reduced to cash) and distributed to creditors in accordance with the procedures mandated by the court. Under Chapter 13, debtors file a repayment plan with the court agreeing to pay their debts over time, usually 3 to 5 years.

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participants in the credit counseling industry spurred federal and state investigations into the activities of many credit counseling agencies. Over the past few years, the FTC has settled enforcement actions against several agencies, and the IRS has undertaken a broad examination effort of credit counseling organizations for compliance with the Internal Revenue Code.

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## The Trustee Program's Process for Screening Providers Is Designed to Help Ensure Statutory and Program Requirements Are Met

The Bankruptcy Act provided that credit counseling and debtor education agencies meet certain minimum requirements designed to ensure that providers are adequately qualified and to prevent abusive practices. For example, with regard to credit counseling, the Trustee Program may approve only entities that are nonprofit organizations, have an independent board of directors, provide full disclosures to clients on certain items, and provide trained counselors with adequate experience.<sup>8</sup> The act required the Trustee Program to undertake a thorough review of the qualifications of a credit counseling or debtor education agency before approving it to provide services. In July 2006, the Trustee Program adopted an interim final rule setting forth application procedures designed to ensure that only organizations meeting the minimum qualification standards set forth in the Bankruptcy Act would be approved to provide services.<sup>9</sup>

To implement the relevant provisions of the Bankruptcy Act, the Trustee Program established its Credit Counseling and Debtor Education Unit in June 2005 and developed a process for approving providers.<sup>10</sup> A wide range of industry participants told us that the Trustee Program had generally been successful in setting up an infrastructure, establishing guidance and

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<sup>8</sup>Nonprofit status is a state law concept. The Bankruptcy Act does not require that a credit counseling agency be qualified as a 501(c)(3) tax-exempt organization in order to be an approved provider. However, an organization's federal tax-exempt status is one factor considered by the Trustee Program in determining an agency's nonprofit status for purposes of being an approved provider.

<sup>9</sup>Application Procedures and Criteria for Approval of Nonprofit Budget and Credit Counseling Agencies and Approval of Providers of a Personal Financial Management Instructional Course by United States Trustees, 71 Fed. Reg. at 38076 – 38085 (2006). Qualifications for credit counseling providers, see 71 Fed. Reg. at 38078 - 38080 (to be codified at 28 C.F.R. § 58.15). Qualifications for debtor education providers, see 71 Fed. Reg. at 38082 - 38084 (to be codified at 28 C.F.R. § 58.25).

<sup>10</sup>OMB No. 1105-0084 (Exp. 12/31/2005), *Application for Approval as a Nonprofit Budget and Credit Counseling Agency*, and OMB No. 1105-0085 (Exp. 12/31/2005), *Application for Approval as a Provider of a Personal Financial Management Instruction Course*.

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an application process, and approving providers within a very limited time frame. Credit counseling agencies applying to become approved providers—or reapplying to maintain their status as providers—must provide the Trustee Program with a variety of information that is used to evaluate the agencies’ qualifications, including the written materials the agencies use in providing credit counseling services and information on debt management plans serviced by the agency.<sup>11</sup> In addition, applicants must disclose information about their nonprofit status and any actions that have affected the organization, including any revocations of licenses or accreditations, investigations, and legal, disciplinary or enforcement actions.

In general, we found that the Trustee Program’s process for reviewing applicants was generally systematic and thorough and designed to ensure that the applicants approved by the program met the qualification standards set forth in the Bankruptcy Act. For example, the review process includes measures to evaluate the applicants’ character and standing in the credit counseling industry. In particular, agencies that enter a high proportion of clients into debt management plans may be asked to provide additional information on the number and nature of these plans. In some cases we reviewed, the Trustee Program required applicants to make modifications to their programs or processes, such as adding additional material to the disclosure statements provided to clients, before it would approve the providers.

As of October 2006, the Trustee Program had approved 153 credit counseling providers. As required by statute, all of these providers were nonprofit organizations, and about 94 percent of them had federal tax-exempt status under section 501(c)(3) of the Internal Revenue Code. The program had also approved 268 debtor education providers by October 2006, of which at least one-third were organizations exempt under section 501(c)(3). Many providers were approved for both credit counseling and debtor education, and three large nationwide companies have provided about half of the sessions for both of these services.

There have been relatively few complaints raised about providers’ competence or integrity. The great majority of representatives of

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<sup>11</sup>Debt management plans refer to repayment programs offered by some credit counseling agencies. Under these plans, consumers pay off their unsecured debts by making a single, consolidated payment that the agency uses to disburse funds to creditors.



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consumer advocacy groups, federal agencies, industry participants, and other stakeholders we spoke with believed that the credit counseling agencies approved by the Trustee Program have been reputable. In addition, no federal or state law enforcement officials we spoke with identified any federal or state enforcement actions related to consumer protection issues against any credit counseling providers subsequent to their approval. Between October 2005 and October 2006, the Trustee Program received 124 complaints about credit counseling and debtor education providers, out of more than 930,000 certificates issued. Our analysis found that many of the complaints were related to administrative issues, such as the timely issuance of a debtor's certificate. Twenty complaints alleged unfair or inappropriate practices, such as giving legal advice, discouraging customers from filing for bankruptcy, or failing to inform clients about the possibility of a fee waiver. Our review of a selection of complaints found that the Trustee Program took action to assess and follow up on each complaint. In no case did a complaint result in the Trustee Program removing a provider from the approved list, according to a program official.

As part of its Credit Counseling Compliance Project, which began in October 2003, IRS began a broad examination effort of the entire credit counseling industry, focusing on whether agencies met the requirements for federal tax exemption under section 501(c)(3) of the Internal Revenue Code.<sup>12</sup> As of March 2007, IRS had completed 47 examinations, which in all cases resulted in either revocation, proposed revocation, or other termination of the agencies' tax-exempt status. The IRS noted that these revocations occurred because these organizations served primarily to get clients into debt management plans, offered little or no counseling or education, and appeared to be motivated mostly by profit.

No credit counseling provider approved by the Trustee Program had had its federal 501(c)(3) tax-exempt status revoked as of March 2007, according to publicly available documents we reviewed. However, IRS officials told us that four of the credit counseling agencies still under examination were agencies approved by the Trustee Program. A Trustee Program official told us that although the Trustee Program was aware of the ongoing IRS examinations of these four agencies, it approved their

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<sup>12</sup>To qualify for exemption from federal income tax under section 501(c)(3), an organization must be organized and operated exclusively for one or more exempt purposes specified by statute, such as religious, charitable, scientific, literary, or educational purposes.

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applications to become counseling providers because the agencies had satisfied the qualification requirements of the Bankruptcy Act and the Trustee Program’s interim final rule.<sup>13</sup> The official said that should IRS revoke an agency’s tax-exempt status, the program would carefully review the reasons for the revocation and take whatever actions the program deemed appropriate.

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## Counseling and Education Sessions Meet Statutory and Program Requirements, but a Wide Range of Observers Question the Value of the Counseling Session

According to the Bankruptcy Act, the prefiling credit counseling session should provide clients with individualized assessments and help them develop a plan to respond to their financial situation. We did not find evidence that counselors were providing biased information and few clients appear to be entering debt management plans. However, a wide range of observers have questioned the value of the credit counseling requirement since by the time most clients received the counseling their financial situations were dire, leaving them with no realistic alternative to bankruptcy. By contrast, most observers we spoke with believed that the predischarge debtor education requirement—a general financial literacy course—was beneficial.

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## Credit Counseling Sessions Are Designed to Provide Debtors with Individualized Assessments

The Bankruptcy Act describes the required prefiling credit counseling as “an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outline[s] the opportunities for available credit counseling and assist[s] such individual in performing a related budget analysis.”<sup>14</sup> The act requires that this session include an analysis of a client’s current financial condition and the factors that caused this condition and help develop a plan to respond to the client’s problems that would not involve incurring additional debt. Trustee Program officials told us that it was widely understood that the content of the prefiling counseling session would closely resemble the traditional sessions that reputable credit counseling agencies had provided for many years.

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<sup>13</sup>Because these four agencies were under active examination at the time of our review, IRS and the Trustee Program did not provide us with the identities of these four providers or information on the status of their examinations.

<sup>14</sup>11 U.D.C. § 109(h)(1).

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Our review of the Trustee Program’s case files and counseling materials of 15 credit counseling providers—representing more than two-thirds of certificates issued—showed that the content of the credit counseling sessions, as described in the written materials, was in accordance with the requirements of the Bankruptcy Act. Credit counseling sessions generally began with providers collecting data on the client’s finances, including sources and amount of income, debt, and expenses. Individual counselors then typically analyzed the data with a software program and provided the client with a personalized budget. They discussed the client’s financial goals and potential opportunities for reducing spending and paying off debt. Counselors then described the client’s options—for example, developing a budget, entering into a debt management plan, or filing a Chapter 7 or Chapter 13 bankruptcy. When the sessions were over, counselors issued certificates verifying that the client has completed the prefiling credit counseling requirement.

Although most providers offered clients the option of conducting credit counseling sessions in person, available data indicated that most debtors fulfilled their prefiling requirements by telephone or via the Internet. Trustee Program data collected on certificates issued between July 11 and October 17, 2006, indicated that 45 percent of all prefiling counseling sessions were conducted by telephone, 43 percent were conducted via the Internet, and 13 percent were conducted in person.<sup>15</sup> Academic researchers, counseling providers, and other experts we spoke with said that although in-person counseling may have advantages, telephone counseling can be an effective method of delivery. We did not find any significant research on the effectiveness of credit counseling facilitated via the Internet. To receive counseling using this method, a client generally logs on to the provider’s Web site and inputs the same data on his or her finances that would be provided during a telephone or in-person session. On the basis of these data, the client is typically provided information and a financial analysis, including a description of the available alternatives. Trustee Program officials told us all approved Internet-based credit counseling sessions were required to include a separate component in which the client communicated individually with a counselor.

Prior to passage of the Bankruptcy Act, some consumer advocacy groups, policymakers, and others expressed concerns that credit counseling provided under the act might sometimes be biased and not in the clients’

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<sup>15</sup>Percentage does not add up to 100 due to rounding.

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best interests. Specifically, concerns existed that providers might inappropriately discourage clients from filing for bankruptcy and instead encourage them to enter into debt management plans that benefited the agency but not the debtor. However, available evidence indicates that only a very small number of clients—fewer than 2 percent—receiving prefiling credit counseling have entered into any debt management plan.<sup>16</sup> In general, representatives of consumer groups, panel trustees, and others told us that they had not observed cases where prefiling counseling agencies inappropriately encouraged clients to avoid filing for bankruptcy.<sup>17</sup> As of October 2006, the Trustee Program had received only five formal complaints—out of more than 650,000 credit counseling certificates issued—alleging that providers made harmful or inappropriate recommendations.

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### Many Question the Value of the Counseling Requirement, but Data on Outcomes Are Limited

The report of the House of Representatives Committee on the Judiciary that accompanied the bill that became the Bankruptcy Act indicated that the purpose of the credit counseling provisions was to ensure that consumers could “make an informed choice about bankruptcy, its alternatives, and consequences.”<sup>18</sup> The report further noted that the counseling was intended to give consumers in financial distress “an opportunity to learn about the consequences of bankruptcy—such as the potentially devastating effect it can have on their credit rating” before they decided to file for bankruptcy relief.<sup>19</sup>

However, it is unclear whether the credit counseling requirement is achieving its intended purpose. While quality credit counseling can, in general, be beneficial, a wide range of observers whom we spoke with—including representatives of federal agencies and bankruptcy attorneys; consumer advocates; and several counseling providers—told us that the timing of the counseling conducted to fulfill the requirement of the Bankruptcy Act could mitigate its value. The federal Financial Literacy and

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<sup>16</sup>Anecdotal evidence we gathered was corroborated by a survey by the National Foundation for Credit Counseling of its member agencies indicating that about 3 percent of clients who signed up for prefiling counseling from October 2005 through August 2006 enrolled in a debt management plan.

<sup>17</sup>Panel trustees and standing trustees are overseen by the Trustee Program and administer individual Chapter 7 and Chapter 13 bankruptcy cases, respectively.

<sup>18</sup>H.R. Rep. No. 109-31, Part I, at p. 2 (2005).

<sup>19</sup>H.R. Rep. No. 109-31, Part I, at p. 18 (2005).

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Education Commission noted in its national strategy that reputable credit counseling could have a significant positive impact, making borrowers more creditworthy and decreasing their debt. But the strategy also recommended that consumers seek credit counseling services early, when financial problems started, in order to avoid potential bankruptcy.<sup>20</sup> In practice, however, by the time individuals obtain pre-filing credit counseling, they usually have already consulted with a bankruptcy attorney and have serious financial problems, such as imminent foreclosure on their homes. As such, anecdotal evidence indicates that the great majority of clients receiving pre-filing counseling have few viable alternatives to bankruptcy.<sup>21</sup> The Bankruptcy Act's credit counseling requirement therefore may not be serving its purpose of helping consumers make informed choices about whether or not to file for bankruptcy. Providers and others told us that many clients perceived the counseling session as an administrative obstacle rather than a useful exercise.

Questions about the value of the pre-filing requirement stem from a widespread belief among observers that nearly all of the consumers that receive the credit counseling subsequently file for bankruptcy. Yet the evidence for this is largely anecdotal, as comprehensive data do not currently exist on the outcomes of those consumers who receive pre-filing credit counseling. Neither the Trustee Program, credit counseling providers, or any other party currently tracks how many consumers who receive credit counseling subsequently file for bankruptcy. A Trustee Program official told us that the program had not taken steps to track and monitor these outcomes because doing so was not part of its statutory responsibilities. As we have reported in the past, meaningful data on program outcomes and costs are essential for appropriate oversight and

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<sup>20</sup>Financial Literacy and Education Commission, *Taking Ownership of the Future: The National Strategy for Financial Literacy* (Washington, D.C.: April 2006), pp. 31, 32, and 38.

<sup>21</sup>The number of bankruptcy filings increased substantially just prior to the implementation of the Bankruptcy Act because many consumers believed it would be more difficult to receive bankruptcy protection once the act went into effect, according to organizations representing bankruptcy attorneys and other observers we spoke with. Debtors filing for bankruptcy shortly after the implementation of the act may therefore not be representative of future debtors.

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decision making.<sup>22</sup> Without reliable data on the outcomes of the prefiling credit counseling sessions, policymakers and program managers lack the information that would allow them to determine how well the statutory requirement is truly serving to inform consumers about their options. In our report, we recommend that the Trustee Program develop a mechanism that would allow the program or other parties to track the outcomes of prefiling credit counseling, including the number of individuals issued counseling certificates who then file for bankruptcy. This may involve working in conjunction with the Administrative Office of the U.S. Courts to ensure that the unique certificate numbers issued by the Trustee Program can be linked to bankruptcy petitions filed with the courts. In commenting on a draft of our report, the Trustee Program said that it concurred with this recommendation and noted that it plans to refine and expand its current tracking and data collection methods, as well as explore the feasibility of developing more comprehensive outcome measures.

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## Debtor Education Sessions Are Designed to Offer Financial Management Skills

The debtor education requirement is described in the Bankruptcy Act as an “instructional course concerning personal financial management,” which may be provided in person, by telephone, or via the Internet.<sup>23</sup> The Trustee Program’s interim final rule specified that the course should include written information and instruction on four major topics: budget development, money management, wise use of credit, and consumer information.<sup>24</sup> We reviewed the debtor education curricula, teaching guides, and other materials from 17 debtor education providers, and found that the content included the topics and elements that the Trustee Program required. Trustee Program data collected on certificates issued between July 11 and October 17, 2006, indicated that 50 percent of pre-discharge education sessions were conducted by Internet, 29 percent via telephone, and 21 percent in person.

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<sup>22</sup>For example, see GAO, *Program Evaluation: OMB’s PART Reviews Increased Agencies’ Attention to Improving Evidence of Program Results*, [GAO-06-67](#) (Washington, D.C.: Oct. 28, 2005); *Results-Oriented Government: GPRA Has Established a Solid Foundation for Achieving Greater Results*, [GAO-04-38](#) (Washington, D.C.: Mar. 10, 2004); and *Managing for Results: Using GPRA to Assist Congressional and Executive Branch Decisionmaking*, [GAO/T-GGD-97-43](#) (Washington, D.C.: Feb. 12, 1997).

<sup>23</sup>See 11 U.S.C. § 111(d)(1)(C).

<sup>24</sup>71 Fed. Reg. at 38082 (to be codified at 28 C.F.R. § 58.25(f)).

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Most representatives of consumer groups, bankruptcy attorneys, and other observers we spoke with believed that the pre-discharge debtor education course was likely to help improve consumers' financial literacy. As we have noted in earlier reports, we believe that ensuring that Americans have the knowledge and skills to manage their money wisely is a key element in improving the economic health of our nation for current and future generations.<sup>25</sup> Financial education efforts that seek to achieve goals such as reducing Americans' debt are key to helping improve our citizens' economic security and our country's economic growth.

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## Provider Fees Are Generally Considered Reasonable, Although Fee Waiver Policies Vary

The Bankruptcy Act requires that credit counseling and debtor education providers charge reasonable fees for their services and provide these services without regard to the client's ability to pay. Trustee Program staff, providers, and trade association representatives told us that most providers charged around \$50 each for their credit counseling and debtor education sessions. This estimate was corroborated by survey data collected from 107 providers by the National Foundation for Credit Counseling.<sup>26</sup> Representatives of consumer groups and legal organizations, as well as academics and others we spoke with, generally believed that the fees credit counseling and debtor education providers had been charging were reasonable.

The Trustee Program has required providers to disclose their fee schedules in their applications, and, as of July 2006, has also required providers to disclose their policies for reducing or waiving fees based on the client's ability to pay.<sup>27</sup> A program official told us that providers' waiver policies are reviewed during the application process to ensure that they are clear and objective, and noted that in some cases applicants had been rejected for inadequate fee waiver policies.

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<sup>25</sup>For example, see GAO, *Financial Literacy and Education Commission: Further Progress Needed to Ensure an Effective National Strategy*, [GAO-07-100](#) (Washington, D.C.: Dec. 4, 2006) and *Highlights of a GAO Forum: The Federal Government's Role in Improving Financial Literacy*, [GAO-05-93SP](#) (Washington, D.C.: Nov. 15, 2004).

<sup>26</sup>National Foundation for Credit Counseling, *Consumer Counseling and Education Under BAPCPA: Year One Report* (Silver Spring, Md.: Oct. 16, 2006). This report provided data on the agencies' average revenue per session, which factored in cases where fees were reduced or waived. However, the foundation provided us with the underlying data from its survey, which we used to determine the average price charged to consumers who did not have their fees reduced or waived.

<sup>27</sup>71 Fed. Reg. at 38078-79 and 38082-83 (to be codified at 28 C.F.R. §§ 58.15(e) and 58.25(j)).

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Providers' policies for waiving fees varied. For example, the three largest providers used differing criteria—one told us it waived fees for clients at or below 150 percent of the poverty line, a second for clients at or below 120 percent of the poverty line, and a third based on whether the client received free legal aid or had disability income. Providers we spoke with generally said that they allowed counselors to use their discretion to waive fees in additional circumstances as well. According to Trustee Program data, the three largest providers waived their fees 4 percent, 15 percent, and 26 percent of the time for credit counseling sessions, and 6 percent, 21 percent, and 34 percent of the time for debtor education courses.

The Bankruptcy Act does not specify what constitutes a client's "ability to pay." In addition, the Trustee Program has not issued formal guidance on determining a client's ability to pay. Some providers told us that the lack of guidance left them unsure about the criteria they should use and said that additional guidance would be beneficial. Eight of the 22 comments to the Trustee Program's interim final rule submitted by providers, industry associations, and consumer groups requested that the program provide guidance or clarification on what constitutes a client's ability to pay. Trustee Program officials told us that they were considering issuing a rule that would formalize the criteria that providers should use to determine clients' ability to pay but that they had not made a final decision.

We believe that clearer guidance on determining clients' ability to pay could have several benefits, including reducing uncertainty among providers, providing greater transparency, and ensuring compliance with minimum standards. As such, our report recommends that the Trustee Program issue formal guidance on what constitutes ability to pay. In developing this guidance, the program should examine the reasons behind the variations among providers in waiving fees. In addition, while this guidance should set a minimum benchmark for determining when fees should be reduced or waived, it should not limit or discourage providers that may wish to waive fees for more clients than qualify under the minimum benchmark. In its comment letter, the Trustee Program agreed with our recommendation and said it will promulgate formal fee waiver guidance in a rulemaking later this year.



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## The Supply of Providers Appears Sufficient, and Actions Are Under Way to Address the Challenges Some Consumers May Face Fulfilling the Requirements

Before the Bankruptcy Act went into effect, some members of Congress, consumer advocates, and others worried that not enough counseling services would be available within the required time frame for people filing for bankruptcy. Our review of the limited data available and anecdotal evidence indicated that the supply of credit counseling and debtor education services has been adequate to meet the demand for these services. When the Bankruptcy Act went into effect in October 2005, the Trustee Program had approved 71 credit counseling and 76 debtor education providers. By October 2006, this number had risen to 153 credit counseling and 268 debtor education providers, including about a dozen that provide services nationwide. A wide range of participants in the bankruptcy process—including bankruptcy attorneys, a bankruptcy court representative, and service providers—told us that getting access to these services in a timely manner had generally not been a barrier to filing or receiving discharge of debts. Additionally, some noted that consumers who called to schedule a credit counseling or debtor education session were usually accommodated within 24 hours, and sometimes much sooner.

An analysis of existing data suggests that in-person counseling and education sessions are accessible to most of those who need them—particularly in metropolitan areas—but are not easily accessible in certain portions of the country. However, this concern is somewhat mitigated by the fact that the great majority of clients appear to prefer telephone or Internet counseling. Among participants in the process with whom we spoke, the consensus was that debtors sought to conduct the counseling and education sessions by telephone or Internet because these were the quickest and most convenient methods for satisfying the statutory requirements.

Some policymakers, consumer advocates, and others have expressed concern that the credit counseling requirement may create hardship for some debtors by delaying their ability to file a bankruptcy petition and receive the automatic stay that prohibits creditors from continuing to seek payment. This stay can be very important to some debtors—for example, those facing foreclosure on their homes. Some potential bankruptcy filers may face certain challenges in accessing credit counseling and debtor education. For example, consumer and language access advocates, as well as representatives of bankruptcy attorneys, told us they were concerned about the ability of some non-English speakers to receive counseling and education services in their native languages in a timely and effective manner. The Trustee Program has ongoing and planned measures in place to allow consumers to better identify language and translation services

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offered by providers. The program's Web site now allows users to identify providers offering services in any one of at least 29 languages. A program official told us that eventually the Web site should allow consumers to search, by provider and location, for all languages and translation services offered.

Finally, in some cases, individuals who were not represented by an attorney have reportedly attempted to file bankruptcy petitions without having met the prefiling credit counseling requirement. To help mitigate this issue, the uniform set of Official Bankruptcy Forms used by the courts was modified to include a separate exhibit that petitioners attach to attest to compliance with the requirement. Further, the bankruptcy courts have sought to make the requirement more prominent on their Web sites.

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Madam Chairwoman, this completes my prepared statement. I would be happy to respond to any questions you or other members of the Subcommittee may have at this time.

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## Contacts and Acknowledgments

For further information on this testimony, please contact Yvonne D. Jones at (202) 512-8678. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Jason Bromberg, Anne A. Cangi, Emily R. Chalmers, Carl M. Ramirez, and Omyra Ramsingh.

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