RESEARCH BRIEF

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In Search of a Fresh Start: Can Credit Counseling Help Debtors Recover from Bankruptcy?

The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) includes two educational provisions which require debtors to complete an approved credit counseling course prior to filing for bankruptcy and a financial education course prior to the discharge. Concerns have been raised, though, that the counseling requirement may be placing undue hardship on debtors who are already overwhelmed financially. Some argue that the requirement is serving as an administrative obstacle, especially to those on the verge of losing their homes and who have no other option but to file for bankruptcy. Others assert that the counseling has *educational value* and that repealing this requirement would prevent debtors from getting the knowledge and skills they need to better manage their finances and build future financial security.

A multiphase research study was launched in 2009 to investigate the impact of BAPCPA's counseling and education requirements. The goal of the study was to track debtors through the entire bankruptcy process and follow up with them to assess the long-run impacts of the requirements on debtors' overall financial well-being. In the first phase of the study, data were collected from a national sample of debtors who participated in a bankruptcy counseling course offered by Money Management International, Inc. (MMI). The purpose of this study was to measure and quantify the *educational value* of the counseling experience and to identify specific groups of debtors who were more likely than others to benefit from the counseling requirement.

The results from the first phase of the analysis reveal that debtors significantly benefited from the counseling requirement and were satisfied with their overall counseling experience.

The following were key findings:

- **Increased knowledge** – Debtors were administered a financial knowledge test before and after the counseling. Most debtors were fairly knowledgeable prior to the counseling, yet still showed significant improvement in overall financial literacy after the counseling. On average, debtors scored 77.1% correct on the pre-test and 85.9% correct on the post-test – an increase in knowledge of 11.4%.

- **Improved attitudes and behavioral intentions** – Debtors experienced significant and positive changes in their financial attitudes and behavioral intentions. By the end of the counseling, debtors appeared to be at a “teachable moment” where they were more aware of their current financial practices and were motivated to want to take action and improve their financial situation.

- **Increased financial confidence** – As a result of the counseling, over 97.0% of debtors felt more knowledgeable about the bankruptcy process and the options available to deal with their current financial problems. Over 91.0% felt that their overall ability to manage their finances had improved.

- **Positive outcomes for those with poor financial management practices** – Half of all debtors reported that their financial situation was due to unnecessary spending. These debtors, when compared to those whose financial situation was not due to financial mismanagement, were more likely to become financially knowledgeable and to indicate that they would engage in more positive financial behaviors post-counseling.

- **Assistance for those in unfortunate circumstances** – Those whose financial problems were due to unfortunate circumstances such as illness and unemployment also benefited from the counseling. Their financial knowledge increased and they intended to engage in more positive financial practices post-counseling. Improvements in knowledge and behavior, though, were similar to those whose financial problems were unrelated to an unfortunate event. This suggests that on average debtors benefited from the counseling regardless of whether their indebtedness resulted from unfortunate circumstances beyond their control or from poor financial decisions.

- **Socioeconomic status matters** – Those with higher incomes and education were also significantly more likely to experience improvements in knowledge, attitudes, and behavioral intentions. Interestingly, higher-income clients were less likely to report positive financial practices prior to counseling, but more likely to report positive (intended) practices after counseling. This is most likely because indebtedness among high-income clients was primarily the result of poor financial management rather than unfortunate events.

- **Satisfaction with counseling** – Overall, debtors were very satisfied with their bankruptcy counseling experience. Over 99.0% found the counseling course helpful and about 97.0% indicated they would be likely to seek counseling again if they had financial problems in the future. Almost all debtors seemed to appreciate the educational value of the counseling and did not feel that the requirement had been a burden or an administrative obstacle.

The counseling requirement was included in BAPCPA to help debtors make an informed choice about bankruptcy and to provide them with the financial skills necessary to better manage their money and avoid future financial problems. The counseling provides a mechanism at the national level to ensure that financially overwhelmed debtors receive some type of educational assistance.

To date though, very little research has been conducted to empirically investigate the effectiveness of the counseling mandate. Can counseling help debtors recover financially from bankruptcy? Do debtors benefit educationally from the experience? Are there specific groups of debtors who are more likely to benefit from the counseling than others? These were some of the key questions this study attempted to address. Overall, the results showed that debtors appear to have benefited from the counseling and seem to be satisfied with the services they had received. It remains to be seen though what happens after these debtors file for bankruptcy. Does the counseling help them to get a "fresh start" financially? Are they able to put into practice what they learned from the counseling?

Phase two of this study, which is currently underway, attempts to address these issues. Follow up data have already been collected. Preliminary evidence points to marked improvement in debtors' financial management skills and practices post-bankruptcy. These findings suggest that credit counseling may in fact be a viable mechanism to help debtors deal with their financial situation and obtain a fresh start. The results from phase two are scheduled for release later this year.

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