



## **CRS Report for Congress**

# **Preliminary Observations on the Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (P.L. 109-8)**

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### **Summary**

The Bankruptcy Abuse Prevention and Consumer Protection Act, signed into law on April 20, 2005, was intended to prevent the filing of abusive bankruptcy petitions and to encourage debtors with regular incomes to repay as much of what they owed as possible. The perceived effect of these amendments was to make the bankruptcy code significantly more favorable to creditors. As a result, there was a “rush to the courthouse” between the date of enactment and the effective date, October 17, 2005. During that period, record numbers of consumer bankruptcy petitions were filed.

During 2006, by contrast, the number of filings dropped sharply, to less than a quarter of the 2005 figure. No doubt much of the decline is explained by what happened during the transition — many consumer bankruptcies filed in 2005 were accelerated by the enactment of the new law and would otherwise have been filed in 2006 or later. At the same time, part of the slowdown may be permanent, if the new law is having its intended effect of discouraging certain types of filings. With only one year’s data under the new law, it is too soon to conclude what the lasting impact will be. This report examines the evidence to date, and offers some preliminary observations on the numbers and types of bankruptcy petitions filed. It will be updated as new statistics become available.

Despite the fact that two of the longest economic expansions in U.S. history occurred during the 1980s and 1990s, the number of consumer bankruptcy filings rose sharply during those decades (and continued to rise after 2000). This paradox attracted two kinds of explanations. Some analysts detect a growing “financial fragility” among American families — factors such as medical costs, stagnant median wages, low rates of saving, or increased dependence on two incomes are said to make households more vulnerable to financial shocks. Others argued that the bankruptcy code itself was driving up the number of filings. In this view, the existing law made it too easy for consumers to have their debts discharged (or erased) by the courts, and thus created an incentive for imprudent or

even fraudulent borrowing. Behind the 2005 bankruptcy reform legislation lay “a growing perception that bankruptcy relief may be too readily available and is sometimes used as a first resort, rather than a last resort,” and that the law was full of “loopholes and incentives that allow and — sometimes — even encourage opportunistic personal filings and abuse.”<sup>1</sup>

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was meant to “respond to many of the factors contributing to the increase in consumer bankruptcy filings, such as lack of personal financial accountability, the proliferation of serial filings, and the absence of effective oversight to eliminate abuse in the system. The heart of the bill’s consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism (‘needs-based bankruptcy relief’ or ‘means testing’), which is intended to ensure that debtors repay creditors the maximum they can afford.”<sup>2</sup>

The means test weighs debtors’ income against their debts and living expenses according to an arithmetical formula contained in the statute.<sup>3</sup> In general, debtors whose income — net of specified expenses and allowances — exceeds certain thresholds are not allowed to file Chapter 7 bankruptcies (where debts are discharged and consumers are free to make a fresh start) but must either file Chapter 13 petitions (under which they agree to repay part of their debts over a period of several years under a court-approved plan) or receive no bankruptcy relief at all.<sup>4</sup>

Thus, the new law — if it works as its sponsors intended — should have two effects. Consumers with steady incomes and the ability to repay, who filed Chapter 7 petitions under the old law, should be steered into Chapter 13. Second, the total number of bankruptcies should decline as “opportunistic” filings are deterred. The tables below present the data that bear on these questions.

## Total Number of Filings

**Table 1** below shows quarterly nonbusiness bankruptcy filings since the beginning of 2002. Through the first quarter of 2005, these figures show no clear trend but fluctuate at a very high level by historical standards. In the second quarter, the rush to file under the old law becomes apparent: the 458,597 filings reported were an all-time quarterly high. The record did not last long — the number jumped to 532,526 in the third quarter and then to 654,633 in the fourth quarter, when the new law took effect (on October 17). Dramatic as these increases are, the quarterly data actually conceal how abrupt the transition was. The Administrative Office of the U.S. Courts, against its usual practice, published monthly data for 2004 and 2005. In October 2005, 619,588 nonbusiness cases were filed. In November, the figure fell to 13,643.

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<sup>1</sup> House Committee on the Judiciary, *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, H.Rept. 109-31, part 1, pp. 4-5.

<sup>2</sup> Ibid, p. 2.

<sup>3</sup> See CRS Report RS22058, *Bankruptcy Reform: The Means Test*, by Mark Jickling.

<sup>4</sup> In the absence of federal bankruptcy relief, creditors are free to pursue state law remedies to collect what is owed them.

**Table 1. Nonbusiness Bankruptcy Filings by Chapter, 2002-2006**

Quarter Ending	Nonbusiness Filings				Ch. 13 as % of Total
	Total	Chap. 7	Chap. 11	Chap. 13	
Dec 2006	172,013	98,824	134	73,052	42.5%
Sept 2006	165,862	96,442	140	69,280	42.0
Jun 2006	150,975	91,674	131	59,170	39.2
Mar 2006	112,685	63,250	121	49,314	43.8
Dec 2005	654,633	560,654	263	93,714	14.3
Sep 2005	532,526	422,467	225	109,833	20.6
Jun 2005	458,597	356,389	190	102,017	22.2
Mar 2005	393,086	289,269	201	103,646	26.4
Dec 2004	363,890	254,518	253	109,116	30.0
Sep 2004	388,864	274,196	213	114,454	29.4
Jun 2004	412,861	302,803	214	109,843	26.6
Mar 2004	397,006	285,787	280	110,939	27.9
Dec 2003	385,054	270,519	226	114,308	29.7
Sep 2003	404,543	287,187	235	117,119	29.0
Jun 2003	430,926	312,221	251	118,452	27.5
Mar 2003	404,154	285,883	242	118,029	29.2
Dec 2002	385,629	270,527	224	114,874	29.8
Sep 2002	391,873	275,594	245	116,033	29.6
June 2002	390,991	280,891	254	109,843	28.1
Mar 2002	369,237	259,447	261	109,527	29.7

Source: Administrative Office of the U.S. Courts.

**Figure 1. Nonbusiness Chapter 7 and 13 Bankruptcy Filings, 2002-2006**

Source: Administrative Office of the U.S. Courts.

In December 2005, the number of filings increased slightly, and the rising trend continued through 2006. Given that the latest figures remain far below pre-2005 levels, it seems likely that the aftereffects of the rush to file triggered by the new law are still being felt. This suggests that filings will continue to rise into 2007. It remains to be seen whether filings will level off before they reach the levels that prevailed a few years ago under the old bankruptcy law.

## Chapter 7 Versus Chapter 13

A major aim of the 2005 bankruptcy amendments was to steer debtors with the ability to repay at least some of their debts into Chapter 13, where the bankruptcy court collects part of the debtor's income for a number of years and distributes it to creditors. Before 2005, about 30% of all nonbusiness cases were Chapter 13, and virtually all the rest were Chapter 7.<sup>5</sup>

The data in **Table 1** illustrate that the rush to file before the effective date of the new law was in fact a rush into Chapter 7. Even though the total number of filings in 2005 set a record, the number of Chapter 13 cases declined from 2004. Clearly the message that debtors received about the new law was that Chapter 7 relief would become more difficult to obtain, and that Chapter 13 was a considerably less desirable alternative.

The percentage of cases filed under Chapter 13 has varied significantly and persistently from state to state. In 2002, 29% of cases nationwide were Chapter 13, but five states reported that Chapter 13 accounted for a majority of all petitions. On the other hand, ten states had rates of less than 10%.<sup>6</sup> **Tables 2 and 3** break out the 10 states with the highest and lowest Chapter 13 rates in 2002, and present data on what happened there in 2005 and 2006.

**Table 3** shows that the percentage decline in Chapter 13 filings reported in 2005 was greatest in the states that had the highest rates in 2002. In 2006, the percentage of Chapter 13 cases has risen above the historical norm in both high and low rate states, but the increase from 2002 to 2006 is not more pronounced in either group of states. One might have expected the primary impact of the new law to be felt in states where Chapter 13 was relatively rare under the old law, but the data do not show this. Instead, there appears to be an across-the-board increase in the percentage of cases filed under Chapter 13. As in the case of total bankruptcy filings, some of this increase is likely due to the transition experience (when the accelerated filings — and subsequent drop-off — were predominantly Chapter 7 cases), and it is uncertain how far (or whether) the Chapter 13 rate will remain permanently above the pre-reform level.

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<sup>5</sup> Nonbusiness petitioners can file under Chapter 11, which is standard for corporate reorganizations. However, because of the complex and costly procedural requirements, only a few individuals use it, as **Table 1** shows.

<sup>6</sup> The “high Chapter 13” states were mostly in the south, while the “low” states were geographically dispersed, small-population states. The differences are usually explained as a result of varying court norms, or “legal culture.”

**Table 2. Number and Percentage of Nonbusiness Bankruptcies Filed Under Chapter 13, 2002-2006**

State	2002			2005			2006		
	Total	Chapter 13	Chapter 13 as % of total	Total	Chapter 13	Chapter 13 as % of total	Total	Chapter 13	Chapter 13 as % of total
GA	74,354	42,844	57.6%	79,273	34,449	43.5%	39,142	24,355	62.2%
SC	15,575	8,837	56.7	15,352	7,913	51.5	6,047	4,414	73.0
TN	62,473	32,707	52.4	65,360	27,868	42.6	31,406	20,638	65.7
AL	41,478	21,690	52.3	47,513	19,234	40.5	19,420	12,863	66.2
NC	35,806	18,693	52.2	42,402	16,015	37.8	16,838	9,273	55.1
TX	77,056	35,996	46.7	117,612	36,842	31.3	34,550	20,395	59.0
AR	23,264	9,709	41.7	30,142	10,177	33.8	9,288	5,028	54.1
LA	26,461	10,267	38.8	36,024	11,006	30.6	10,750	6,614	61.5
DE	3,140	1,186	37.8	4,150	1,208	29.1	1,284	618	48.1
NJ	40,310	14,712	36.5	48,832	11,834	24.2	13,548	5,677	41.9
Total U.S.	1,536,979	443,952	28.9	2,039,214	407,322	20.0	597,965	248,430	41.5
NH	3,822	361	9.4	5,511	471	8.5	1,707	471	27.6
NM	8,581	767	8.9	11,592	616	5.3	2,426	293	12.1
ME	4,321	366	8.5	6,470	386	6.0	1,238	251	20.3
RI	4,842	393	8.1	5,703	298	5.2	1,573	326	20.7
AK	1,359	110	8.1	2,214	149	6.7	577	90	15.6
WY	2,217	137	6.2	3,183	144	4.5	650	106	16.3
WV	10,109	531	5.3	17,475	619	3.5	2,919	365	12.5
IA	11,454	576	5.0	18,254	895	4.9	4,683	547	11.7
SD	2,540	125	4.9	3,975	293	7.4	900	145	16.1
ND	1,958	79	4.0	3,444	168	4.9	711	93	13.1

**Source:** Administrative Office of the U.S. Courts.

**Table 3. Change in the Percentage of Nonbusiness Bankruptcies Filed Under Chapter 13, for Selected States: 2002-2006**

State	Chapter 13 as a Percent of Total			Percentage Point Change From	
	2002	2005	2006	2002 to 2005	2002 to 2006
GA	57.6%	43.5%	62.2%	-14.2	4.6
SC	56.7	51.5	73.0	-5.2	16.3
TN	52.4	42.6	65.7	-9.7	13.3
AL	52.3	40.5	66.2	-11.8	13.9
NC	52.2	37.8	55.1	-14.4	2.9
TX	46.7	31.3	59.0	-15.4	12.3
AR	41.7	33.8	54.1	-8.0	12.4
LA	38.8	30.6	61.5	-8.2	22.7
DE	37.8	29.1	48.1	-8.7	10.3
NJ	36.5	24.2	41.9	-12.3	5.4
Total U.S.	28.9	20.0	41.5	-8.9	12.6
NH	9.4	8.5	27.6	-0.9	18.2
NM	8.9	5.3	12.1	-3.6	3.2
ME	8.5	6.0	20.3	-2.5	11.8
RI	8.1	5.2	20.7	-2.9	12.6
AK	8.1	6.7	15.6	-1.4	7.5
WY	6.2	4.5	16.3	-1.7	10.1
WV	5.3	3.5	12.5	-1.7	7.2
IA	5.0	4.9	11.7	-0.1	6.7
SD	4.9	7.4	16.1	2.4	11.2
ND	4.0	4.9	13.1	0.8	9.1

**Source:** Administrative Office of the U.S. Courts.

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