Credit Counseling and Debtor Education: New Rules, New Responsibilities

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Since the enactment of the 2005 amendments to the Bankruptcy Code, all individuals filing bankruptcy must first obtain credit counseling from a nonprofit credit counseling agency approved by the United States Trustee.[1] In addition, to obtain a discharge, individual debtors must complete a course in personal financial management (debtor education) from a debtor education provider approved by the United States Trustee.[2] Pursuant to this statutory mandate, in 2006 the United States Trustee Program (USTP) published an interim rule setting forth the substance of applications to provide credit counseling and debtor education, and the procedure for applying for approval.[3] Among other matters, the interim rule concerned the content of credit counseling and debtor education instructional materials, ethical standards, reasonable fees and criteria for fee waivers.

On March 14, 2013, following notice and public comment, the USTP published final credit counseling and debtor education rules (final rules) in the Federal Register, which became effective April 15, 2013.[4] The final rules resolve ambiguities in the interim rule and address practical issues that became evident during the initial years of the credit counseling and debtor education requirements. This article addresses several important changes to the responsibilities of credit counseling agencies and debtor education providers under the final rules.

Fees and Fee Waivers

Credit counseling agencies and debtor education providers may charge a fee, but the fee must be a "reasonable fee" and they shall provide services without regard to ability to pay.[5] The interim rule did not provide guidance concerning the maximum reasonable fee. After careful evaluation of the credit counseling and debtor education industry, the USTP advised credit

1 11 U.S.C. § 109(h).

2 11 U.S.C. §§ 727(a)(11); 1141(d)(3)(C); 1328(g)(1).

3 *Application Procedures and Criteria for Approval of Nonprofit Budget and Credit Counseling Agencies and Approval of Providers of a Personal Financial Management Instruction Course by United States Trustees,* 71 Fed. Reg. 38,076 (July 5, 2006)(codified at 28 C.F.R. §§ 58.15-58.27) (the interim rule).

4 *Application Procedures and Criteria for Approval of Nonprofit Budget and Credit Counseling Agencies by United States Trustees*, 78 Fed. Reg. 16,138 (March 14, 2013) (to be codified at 28 C.F.R. §§ 58.12 -58.24), and *Application Procedures and Criteria for Approval of Providers of a Personal Financial Management Instruction Course by United States Trustees*, 78 Fed. Reg. 16,159 (March 14, 2013) (to be codified at 28 C.F.R. §§ 58.25 – 58.36) (collectively, final rules).

5 11 U.S.C. §§ 111(c)(2)(B); 111(d)(1)(E).

counseling agencies and debtor education providers that it considered a maximum fee of $50 to be reasonable, unless there were specific reasons to charge more.

The final rules codify this presumptively reasonable fee of $50 per client. This amount accommodates the local variance in costs associated with complying with statutory and regulatory obligations and the increasing prevalence of telephone and Internet credit counseling and debtor education, as well as taking into account the requirement that credit counseling agencies operate as nonprofit entities. The presumptively reasonable fee of $50 also takes into consideration the fact that fees have been falling over the last few years. In calendar year 2012, the 10 largest credit counseling agencies, in terms of the number of clients served, charged a weighted average of $31.11 per client.[6]

The final rules permit an agency or provider to exceed the presumptively reasonable fee after receiving approval from the USTP by demonstrating that its costs for delivering the credit counseling or debtor education services justify the higher fee. The agency or provider bears the burden of establishing that its proposed fee is reasonable.

Similarly, the interim rule provided no specific guidance concerning a client's ability to pay, which determines the client's eligibility for a fee waiver, other than to require agencies or providers to supply their criteria for waiving fees to the USTP. In practice, the USTP required agencies and providers to employ objective criteria for assessing ability to pay, such as reference to a fixed financial metric including state and federal poverty guidelines, receipt of social services, or *pro se* filing status in the case of debtor education. Although the USTP required each agency or provider to employ such objective criteria consistently among its clients, it also recognized that differences in fee waiver policies among credit counseling agencies and debtor education providers might result in disparate application of the statutory mandate to provide services without regard to ability to pay. Furthermore, the United States Government Accountability Office (GAO) issued a report in 2007 recommending that the USTP "issue formal guidance on what constitutes 'ability to pay.'" U.S. Gov't Accountability Office, GAO-07-203, Bankruptcy Reform: Value of Credit Counseling Requirement Is Not Clear 41 (2007).

In response to the GAO's recommendation, and to achieve greater consistency across credit counseling agencies and debtor education providers, the USTP initially proposed, in the notices of proposed rulemaking, to adopt a nationwide objective measure of ability to pay by requiring such agencies and providers to waive or reduce fees for clients whose income is less than 150 percent of the poverty level.[7] A number of agencies and providers contended, however, that

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6 The weighted average is an estimate. It was calculated by taking the sum of the number of certificates issued per agency in calendar year 2012 for each of the 10 largest agencies multiplied by the publicly disclosed fee charged by that agency (the fee disclosed in the agency's currently approved application, as confirmed by the agency's Web site on April 18, 2013), divided by the total number of certificates issued by all 10 agencies in calendar year 2012.

7 As used in the final rules, the poverty level refers to the poverty guidelines updated periodically in the Federal Register by the U.S. Department of Health and Human Services under the authority of 42 U.S.C. § 9902(2), as adjusted from time to time, for a household or family of the size involved in the fee determination. For 2013, these guidelines are available at https://www.federalregister.gov/articles/2013/01/24/2013-01422/annual-update-of-the-hhs-poverty-guidelines.

the 150 percent standard was unsustainable and would lead to severe financial losses for them, and that a nationwide objective standard without room for local variation would unduly impact agencies and providers in areas with higher concentrations of low-income clients. Several comments to the notices of proposed rulemaking suggested that the USTP permit agencies and providers to implement a schedule of discounts for clients whose incomes fall below the poverty guidelines, but who can afford to pay some amount.

Taking into account the comments concerning local variation, the final rules provide for a rebuttable presumption of fee waiver eligibility. A client with household income below 150 percent of the poverty level is presumptively entitled to a fee waiver. The presumption may be rebutted, however, and the agency or provider may charge the client a reduced fee, if it determines, based on income information the client submits in connection with credit counseling or debtor education services, that the client is able to pay the fee in a reduced amount.[8]

The rebuttable presumption reduces the burden on agencies and providers, while maintaining adequate protection for consumers, by permitting agencies and providers to determine actual ability to pay as to clients who at first glance appear to merit a fee waiver. Instead of waiving the fee entirely, an agency or provider may charge a client a reduced fee if it determines that the client does, in fact, have the ability to pay some of the fee. The reduced fee may be determined using a sliding scale, of the agency's or provider's design, that takes into account the client's financial circumstances.

Quality of Credit Counseling

Section 111(c)(2)(E) of the Bankruptcy Code requires agencies to provide "adequate counseling with respect to a client's credit problems that includes an analysis of such client's current financial condition, factors that caused such financial condition, and how such client can develop a plan to respond to the problems without incurring negative amortization of debt."[9] The interim rule incorporated these requirements in full.

Use of the Internet to provide credit counseling services has increased in popularity since the inception of the credit counseling requirement to the point that, as of 2012, four out of five counseling sessions take place over the Internet. In fiscal year 2009, 6 percent of counseling took place in person, 24 percent by telephone and 70 percent by Internet or Internet/telephone. By fiscal year 2012, however, a scant 2 percent obtained counseling in person and 16 percent by telephone; 82 percent of counseling took place by Internet. The increase in Internet counseling has led to concern about the quality and duration of Internet counseling sessions, and their compliance with the requirements set forth in 11 U.S.C. § 111(c)(2)(E).

A typical Internet-based counseling session requires the client to submit via the Internet specific financial information concerning income, expenses, assets and debts, and then compares the client's spending and debt-to-income ratio to recommended national norms. The typical counseling session also includes Web pages setting forth generic recommendations addressing

8 28 C.F.R. §§ 58.21(b)(1)(ii) (credit counseling); 58.34(b)(1)(ii) (debtor education).

9 11 U.S.C. § 111(c)(2)(E).

categories of overspending, such as advice to clip coupons if the client spends more than the national average on groceries, as well as generic information concerning the merits of debt repayment plans, debt settlement, direct negotiation with creditors and bankruptcy. That information usually does not vary among clients, and sometimes is not germane to particular clients.

To ensure the quality of Internet based credit counseling is substantially equivalent to in-person services, the USTP has required, as a matter of practice, that agencies offering counseling by Internet engage the client in a subsequent discussion with a live counselor, by telephone, live chat or email. This “mandatory interaction” includes a personalized discussion of the client’s financial situation and a plan to resolve the client’s specific financial problems.

Enforcement of the substantive aspects of the mandatory interaction requirement has been difficult to achieve under the interim rule. Over time, these shortcomings have led to disparities in the quality of counseling consumers receive via the Internet versus counseling through traditional in-person means. Accordingly, the credit counseling final rule includes three new requirements. The first requires substantial equivalence in the substantive quality of counseling services, regardless of the means by which the agency provides counseling. Section 58.20(h)(1) provides that an agency may not provide any client diminished counseling services because the client receives any portion of those counseling services by telephone or Internet.[10] The second bars agencies from providing diminished services to a client based on the client’s anticipated bankruptcy filing. Section 58.20(g) requires an agency to ensure “the type and quality of services do not vary based on a client’s decision whether to obtain a certificate in lieu of other options that may or may not be suggested by the agency.”[11] The third explicitly requires agencies providing counseling by Internet to engage the client in personal interaction with a counselor to ensure the substantively adequate delivery of services. Specifically, section 58.22(a) states, “[i]n the case of Internet counseling and automated telephone counseling, counseling is not complete until the client has engaged in interaction with a counselor, whether by electronic mail, live chat, or telephone, following the automated portion of the counseling session.”[12]

These requirements shall be considered with the statute’s substantive requirements to ensure that all clients receive the same thorough counseling services, whether they receive counseling in person or by other means and regardless of whether they anticipate filing for bankruptcy.

Ethical Standards

To ensure that clients exercise control over their choice of credit counseling agency or debtor education provider, and that the outcome of services is not influenced by the promise of compensation for client referrals from law firms or other third parties, the final rules prohibit referral arrangements involving any form of financial benefit to or from the referring entity.

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10 28 C.F.R. § 58.20(h)(1).

11 28 C.F.R. § 58.20(g).

12 28 C.F.R. § 58.22(a).

Section 58.20(d) of the credit counseling final rule prohibits a credit counseling agency from entering into any referral agreement or receiving any financial benefit that involves the agency paying to or receiving from any entity or person fees for the referral of clients to or by the agency, except payments under a fair share agreement, and from entering into agreements involving counseling services that create a conflict of interest.[13] Debtor education providers are subject to the same restrictions.[14] Although the interim rule prohibited referral arrangements, the final rules make the prohibition more explicit.

In practice, many clients are unaware of the pre-petition credit counseling requirement and obtain a recommendation from bankruptcy counsel concerning credit counseling agencies. Such referrals, on their own, pose no ethical problems for agencies. Other attributes of the referral may, however, constitute financial benefit to the agency or counsel.

One common problem arises when the credit counseling agency or debtor education provider agrees to a fee discount for clients of a particular law firm. When clients pay the agency or provider directly, the discount carries no risk of improper financial benefit to the law firm, since it inures directly to the client. When clients rely on counsel to remit payment for services to the agency or provider–generally from the client retainer–such an arrangement raises the question whether the client benefits from the discount. These arrangements are common, as agencies and providers often establish billing procedures that enable counsel to remit payment on behalf of all clients who obtain a referral to the agency or provider within a particular month. If the client is unaware of the existence and amount of the discount, and counsel neither incorporates the discount into its fee structure nor refunds the client the amount of the discount, retention of discounts constitutes a prohibited financial benefit for the referral.

To ensure compliance with the prohibition against compensated referrals, credit counseling agencies and debtor education providers must provide accurate fee information to clients who pay for services through a third party. Because agencies and providers must provide fee disclosures to the client before providing services,[15] they bear the responsibility for informing the client of any discount and the difference between the ordinary fee and the discounted fee. Also, the agency or provider should inform the client that, to the extent a third party remits payment for services, the client should seek return of any discount from that third party.

In addition, agencies and providers may not "bundle" services by packaging together credit counseling and debtor education services and selling them pre-petition to clients through counsel or otherwise. The final rules prohibit the compulsion to purchase bundled services. The credit counseling final rule states that "[a]n agency shall not require a client to purchase counseling services in connection with the purchase of any other service offered by the agency."[16] Similarly, the debtor education final rule declares that a "provider shall not require a debtor to purchase an

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13 28 C.F.R. § 58.20(d)(4) & (5).

14 28 C.F.R. § 58.33(c)(2) & (3).

15 28 C.F.R. §§ 58.20(l)(1) (credit counseling); 58.33(k)(1) (debtor education).

16 28 C.F.R. § 58.21(d).

instructional course in connection with the purchase of any other services offered by the provider."[17] In addition to running afoul of this prohibition, bundled services are inconsistent with the purpose of the credit counseling requirement because they anticipate the client's decision to pursue bankruptcy when the client may, in fact, not file for bankruptcy relief after reviewing all available alternatives with the credit counselor.

Conclusion

The final rules on credit counseling agencies and debtor education providers impose responsibilities on approved agencies and providers that will help those entities and the USTP fulfill the statutory mandate to provide meaningful pre-petition credit counseling and pre-discharge debtor education. Additionally, the final rules will help ensure that consumers have the information necessary to make an informed choice regarding which credit counseling agency or debtor education provider to employ in providing services.

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17 28 C.F.R. § 58.34(d).