Understanding Bankruptcy

Bankruptcy is a legal proceeding that adjusts the debts of individuals who cannot meet their credit obligations.

Widely seen as the debt management option of last resort, the effects of a bankruptcy filing are both long in duration and extensive. People who follow the bankruptcy rules receive a discharge — a court order that says they don't have to repay certain debts. However, bankruptcy information stays on your credit report for 10 years, and can make it difficult to obtain credit, buy a home, get life insurance, or sometimes get a job. Still, bankruptcy is a legal procedure that offers a fresh start for people who have gotten into financial difficulty and can't satisfy their debts.

Types of Personal Bankruptcy

There are two kinds of personal bankruptcy – Chapter 7 and Chapter 13.

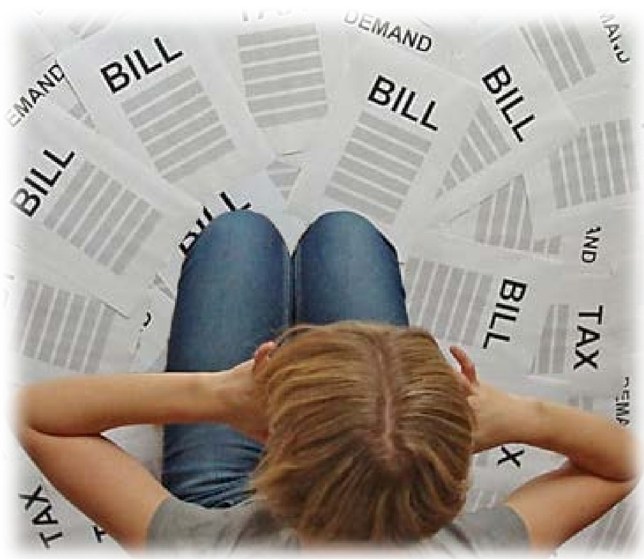
Chapter 7 is known as a "liquidation" bankruptcy because it may require the sale of any personal property not specifically exempted by state law (and states vary in what is protected and what is not, which is why many people move to Florida before filing, because state law allows individuals to keep their primary residence).

Chapter 13 is known as reorganization or "wage earner" bankruptcy since it requires that the debtor have a source of income and make additional debt payments over a three to five year period. The main benefit to Chapter 13 is that is does not affect ownership of personal property.

Both types of bankruptcy may get rid of unsecured debts and stop foreclosures, repossessions, garnishments, and debt collection activities. Both also provide exemptions that allow people to keep certain assets, although exemption amounts vary by state.

Note that personal bankruptcy usually does not erase child support, alimony, fines, taxes, and some student loan obligations. And, unless you have an acceptable plan to catch up on your debt under Chapter 13, bankruptcy usually does not allow you to keep property when your creditor has an unpaid mortgage or legal claim on it - so many filing for bankruptcy lose their home, car, and any valuable personal possessions.

Bankruptcy is a complicated legal process and not everyone qualifies. With limited exceptions, people who plan to file for bankruptcy protection must get



credit counseling from a government-approved organization within 180 days before they file. They also must complete a debtor education course to have their debts discharged.

Further, before you file a Chapter 7 bankruptcy case, you must satisfy a "means test." This test requires you to confirm that your income does not exceed a certain amount. The amount varies by state and is publicized by the U.S. Trustee Program at www.usdoj.gov/ust.

A Note on Student Loans

Student loans are considered a "non-dischargeable" debt, meaning it cannot be erased through normal bankruptcy proceedings. There is one exception, however, and that is "undue hardship."

To demonstrate an undue hardship, you must demonstrate that you cannot maintain a minimum standard of living and still repay your loans (typically involving a medical disability or unemployment), that the bad financial situation is likely to continue, and that you have made an honest effort to repay the loan(s).

Rates of success in discharging student loans are hard to determine because many of those seeking bankruptcy protection do not even attempt to have their student loans discharged. A recent Harvard University Study found that the overall success rate was approximately 40%.

Bankruptcy is very serious choice that has serious, lasting consequences. Use it only as a last resort.

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