

## **Chapter 13 vs. Credit Counseling**

**By Patrick Ritchie**

The banking industry has always been torn in regards to both Chapter 13 bankruptcy and credit counseling. Which is a better solution? Is one worse than the other? Either way, a consumer has accepted that he is experiencing financial hardship and is seeking to remedy the situation. Banks always like it when borrowers make their best effort to repay what they owe.

A Chapter 13 involves a legally binding arrangement signed by a judge. It has some serious clout in terms of its requirements. A creditor cannot come back later and lay claim to a debt that was included in the bankruptcy. However, just the term “bankruptcy” itself can cast a dark shadow over what Chapter 13 does. It allows a debtor to make repayment, but at a level that can be afforded. It is not a liquidation of debt by discharge like the Chapter 7 bankruptcy.

On the same note, credit counseling makes an arrangement to repay creditors a portion of what is owed. The counseling goes a step further and educates the debtor about managing and budgeting money. You know the whole thing about teaching a person to fish and then they can feed themselves for the rest of their lives? The Chapter 13 bankruptcy is just providing a fish, not necessarily teaching a debtor how to avoid such issues in the future. The counseling reviews the credit report with the consumer to provide an understanding that will get someone back on their feet. On the downside, since the process does not utilize the legal system, there is no signature from a judge binding all parties to the terms.

So which one is better than the other? Here are some comparisons:

- With a Chapter 13 bankruptcy you would typically be dealing with an attorney who will prepare everything and make sure it is correct. What happens if they make a major mistake or file the bankruptcy incorrectly? An attorney has a professional standard to uphold and answers to their State Bar Association. A consumer has plenty of recourse to complain about a bad attorney. There is a possibility of an attorney losing his or her license if the Bar Association so chooses, although that would be extreme.
- Credit counseling is more or less a “gentlemen’s agreement” to repay a portion of the debt owed over the course of a specified timeframe. What happens if one of the creditors decides to back out of the arrangement at a later point and sue for the past due amount instead? What if all creditors except one agree to the terms? If any of these things happen it could send the consumer back to square one.
- Most mortgage programs treat Chapter 13 bankruptcy and credit counseling as the same thing. Many people want to avoid the stigma of bankruptcy, but in the eyes of lenders the two things are the same. They both deal with paying off problem debts and getting back on track financially.
- Not all credit counseling agencies are alike. The most important thing to do is for a consumer to make sure the agency is accredited. Many non-profit counseling agencies are just starting out and have no idea what they’re doing. In some cases they are

doing more damage than good. In other cases they are just plain ripping people off. Be careful and find a credible credit counseling agency. Check with the Better Business Bureau ([www.bbb.org](http://www.bbb.org)) before entering into any written agreements or paying out any money.

*Patrick Ritchie is the author of "The Credit Road Map," a practical guide to navigating the world of credit. The book can be purchased at [www.TheCreditRoadMap.com](http://www.TheCreditRoadMap.com) or on [www.Amazon.com](http://www.Amazon.com). Copyright © 2006 Success Road Map Press, reprinted with permission.*