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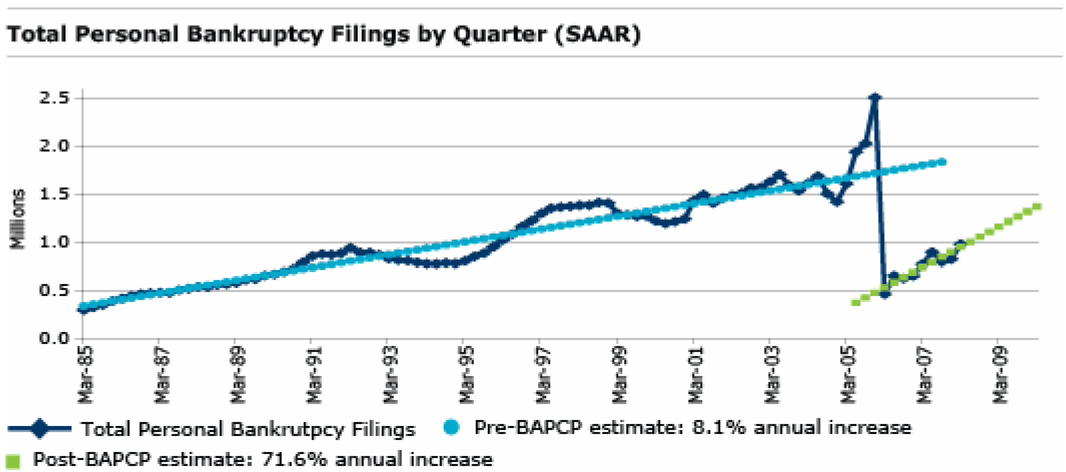
PERSONAL BANKRUPTCY FILINGS ON THE RISE

Historically in the United States, bankruptcy was seen as a mechanism for offering a fresh financial start to individuals and businesses. Under a Chapter 7 bankruptcy filing, a debtor's non-exempt property is liquidated and the proceeds are distributed to creditors to satisfy debts. Under a Chapter 13 filing, a debtor with regular income repays outstanding obligations under a court-approved repayment plan.

During the mid- to late 1990s, some corporations argued that many individuals were behaving in a financially irresponsible manner, running up debt then taking advantage of favorable bankruptcy treatment and walking away from those debts. The *Bankruptcy Abuse Prevention and Consumer Protection Act* (BAPCP), which became effective in October 2005, was an attempt to ensure that consumers who had an adequate means of repaying their financial obligations were required to do so by law. With the expectation that bankruptcy protection for consumers would only worsen under BAPCP, there was an exceptionally large increase in personal filings before the October 2005 deadline. Immediately thereafter, the number of personal filings declined dramatically. At the time, this was regarded as a success for lenders who had realized some losses when weaker borrowers filed for protection but then moved into 2006 with financially stronger consumer portfolios.

Believing that the consumers who did not rush to file for bankruptcy were responsible consumers, many lenders extended additional credit to them in the belief that they would be repaid. However, time has shown that financially distressed individuals continued to file, even under the heavier burden of BAPCP. Although the jump in bankruptcy numbers was less than 200,000 on an annualized basis, the percentage increase from March 2006 to June 2006 was 41%. The annual increase for two short years, from March 2006 to March 2008, averages more than 70%. This is in stark contrast with the average annual 8% increase for the previous 20 years.



SAAR = seasonally adjusted annual rate. BAPCP = *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*.
Source: Administrative Offices, U.S. District Courts via Economy.com.

The vast majority of all consumers repay their financial obligations reliably and both borrowers and lenders benefit from the extension of credit. However, the change in the number of personal bankruptcy filings, before and after BAPCP, provides an interesting insight into credit lending standards and distressed borrowers and lenders. While some consumers borrowed beyond their means and a few lenders originated "predatory" mortgages with usurious terms, the subprime mortgage crisis was triggered by a relatively small number of "bad" loans. Borrowers assumed loans that they couldn't pay, offered by lenders who disregarded the borrowers' inability to pay. Therefore, under these circumstances, BAPCP will protect neither consumers nor lenders.

DBRS believes that a consumer who is truthful about their income cannot borrow irresponsibly without the help of an irresponsible lender. To address the current credit seizure, lenders must begin again to extend credit prudently. That requires the resumption of lending to prime borrowers at non-crisis terms and the extension of credit to subprime borrowers at levels that they can realistically afford.

For questions or comments, please contact Susan Kulakowski at skulakowski@dbrs.com.