HOYES • MICHALOS

& ASSOCIATES INC. – TRUSTEES IN BANKRUPTCY

The Face of Bankruptcy

You May be Similar to the Typical Bankrupt Person

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1. Executive Summary

Hoyes, Michalos & Associates Inc. has provided personal bankruptcy and consumer proposal services to individuals in Ontario since 1999. We are one of the largest firms in Canada practicing exclusively in the area of personal insolvency. To prepare this study we summarized data from all debtors we assisted over a 17 month period ending December 31, 2007. This data demonstrates that the average bankrupt is very similar to the average Canadian, proving the saying that most of us are only one or two missed paycheques away from serious financial problems.

Why is this information important?

Bankruptcy law is changing in Canada. Bill C-12, *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and Chapter 47 of the Statutes of Canada 2005,* was passed by Parliament and received Royal Assent on December 14, 2007. As of the date of this report the new rules have not been proclaimed into force. The new rules will make it more expensive for some Canadians to go bankrupt.

The Senate Standing Committee on Banking, Trade and Commerce is continuing to hold hearings on these proposed new rules, and on future bankruptcy reform.

On February 7, 2008 Douglas Hoyes and Ted Michalos appeared before the Committee to provide expert testimony on the implications of the proposed new rules. Their comments were based in part on "Joe Debtor", the profile of the average bankrupt. We presented this information to the Committee to aid in their deliberations, and to help put a "face" on the average bankrupt.

The common stereotype of the average bankrupt is a person who is unemployed and "down and out". Our data proves that in fact the average bankrupt is working, earns approximately the same as the average Canadian, but is burdened with excessive levels of debt.

An analysis of all of the debtors we have assisted reveals the following profile of the average person that files bankruptcy (or a proposal to their creditors):

Joe Debtor, as we call him, is a male, 42 years old. He has one dependent living with him, either a spouse or a child. His take home pay is about $2,071 a month.

He has total unsecured debt of over $51,100, including $18,335 owing on credit cards, $13,365 on bank loans and lines of credit, and $5,276 in taxes owing.

Our study shows that 33% of these individuals stated that lay-off or reduced incomes contributed to their financial problems, 16% stated that a relationship break up was a primary cause, and 40% admitted that they were over-extended and mismanaged their finances.

Most Canadians in financial difficulty are good, hard working people, but due to divorce, job loss and over use of credit are forced into bankruptcy. They do not follow the typical stereotype of the average bankrupt; in fact, they look like the average Canadian.

2. Introductory Comments

Background

Hoyes, Michalos & Associates Inc. is a professional services firm providing personal insolvency services to individuals in Ontario. Founded in 1999, we operate from more than 20 offices located from Windsor in the west to Toronto in the east. Our practice focuses specifically on personal insolvency – this year alone we will initiate approximately 3,000 new estates for individuals and families in financial difficulty. We are one of the largest independent firms in the country that works exclusively with people, not corporations, so we have a particular interest in helping solve personal financial problems.

Our trustees spend each day meeting with people in financial distress. This is not an academic exercise for us. These are real people who have lost their jobs, gone through a marriage breakup, suffered through an illness, and after these personal tragedies they are faced with the prospect of insurmountable debt.

While many of our debtors freely admit that they have mismanaged their money, the vast majority of people we meet with are not bad people, and we believe it's important that when Parliamentarians draft bankruptcy legislation they remember that real people are affected by the legislation they create.

Our Approach

As required by law, we gather a significant amount of information about each debtor who files with us. We know their income, family size, age, gender, assets, and debts.

We assembled all of that data for everyone who filed with our firm between August 1, 2006 and December 31, 2007. We then analyzed all of that information, and based on an analysis of the insolvent debtors we have assisted, we have developed a description of the "average" bankrupt individual (we call this person Joe Debtor and his complete description appears in Appendix A. Also included is Appendix B, the *Typical Insolvent Debtor Profile*, Appendix C, "*Jane Student" – The Average Insovlent Debtor with Student Loan Debt*).

Our typical insolvent debtor, "Joe Debtor", is a 42 year old man.

(56% of our debtors are male, and 44% of them are female, and we have dealt with debtors as young as 20 years old, and as old as 89).

40% of our debtors are married or living common-law, and 31% of our debtors are separated, divorced or widowed at the time they file.

Joe Debtor has take home pay of $2,071 per month. Joe has one dependent, either a spouse or child, and they contribute on average another $530 per month to the family budget.

Joe has $51,100 in unsecured debt. He owes about $18,000 on credit cards, $13,000 in bank loans, $5,000 in taxes, and about $15,000 on other debts such as finance company loans, payday loans, student loans, and debts to family and friends.

There's a 1 in 5 chance that Joe owns his own home and has a mortgage.

In short, Joe isn't all that different from the average Canadian.

There are lots of Canadians who are male, aged between 30 and 50 years old, with one dependent. Joe Debtor earns $2,071 dollars per month in take home pay; the average Canadian earns $2,831[i] dollars per month, not that much higher than Joe.

So what's the difference between Joe Debtor and the average Canadian?

The average adult Canadian owes about $13,800[ii] in consumer debt, while Joe owes $36,100 on his credit cards, bank loans, and finance company loans. When his tax and other unsecured debts are included Joe owes a crushing total of over $51,000. The cost of servicing Joe's $51,000 of debt works out to around $2,000 per month. It's no wonder that Joe finds himself looking to find some relief through our bankruptcy laws.

Roughly 4 out of every 1000 Canadians file bankruptcy or a proposal each year. That means if you run into 250 people in an average week, one of them is likely to file bankruptcy or a proposal this year. Over a life time, that equates to 10% of the Canadian population.

We believe that the majority of the Joe Debtors that we meet are "honest but unfortunate debtors", and we believe that Parliament should be passing laws to help unfortunate people, not punish them. The *Bankruptcy and Insolvency Act* should be not used as a punitive tool, but rather as part of a rehabilitative process, to restore Joe to his former financial stability.

New Bankruptcy Rules

Full details on proposed new bankruptcy laws can be found at http://www.hoyes.com/new-bankruptcy-rules-in-canada.htm .

The proposed new rules require individuals with the economic means to repay a greater portion of their unsecured debt. A bankrupt with surplus income will now be bankrupt and making payments to his estate for 21 months, as compared to a minimum of nine months of payments under current rules.

Certainly anyone who has the ability to repay a portion of their debts should do so, but at the same time one of the purposes of the *Act* is to provide "an honest, but unfortunate debtor with a fresh start". It is difficult to imagine a person of limited means achieving a fresh start if they are forced to wait for an extended period of time to elapse before they may avail themselves of the bankruptcy process.

In our testimony before the Senate Banking, Trade & Commerce Committee on February 7, 2008 we urged Parliament to consider the crushing burden of debt faced by the average bankrupt, and to avoid laws that punish the average bankrupt, and instead to create laws that help the honest but unfortunate debtor get a fresh start.

3. What Causes Bankruptcy?

If the stereotype of the unemployed bankrupt isn't true, then what causes their financial difficulties?

In our experience, their financial problems develop for a number of reasons.

Obviously, the generic term "financial mismanagement" is a large contributing factor. In fact, when asked for the cause of their financial difficulties, 40% of our debtors listed "over extension of credit and financial mismanagement" as a leading cause of their financial problems. In part due to the guilt associated with filing bankruptcy, most of the people that we see hold themselves wholly responsible for their misfortune and they may not recognize the underlying problems that pushed them into insolvency.

In our experience, a debtor's financial mismanagement was either caused by, or dramatically increased by, a life altering event. The most common of these include marital separation or divorce, job loss, and personal illness.

Separation and Divorce

16% of our clients cited marital or relationship breakdown as the cause of their financial difficulties. 29% of our clients were separated or divorced at the time of their filing.

It is easy to see how the end of a relationship might cause financial problems.

While a couple is together they may have two incomes, but only one set of living expenses (rent, utilities, groceries, etc). They make plans based on the assumption that the relationship will last forever; the incur debt for cars, mortgages on houses, and other consumer items.

Once separated, each partner will have their own rent, utilities and other expenses. They will also be limited to their own income. While they are adjusting to their new reality recently separated people often rely on credit to pay their bills.

This leads to more debt than either party can service, and a proposal or a bankruptcy is often the final result.

Job Loss or Reduced Income

33% of our clients indicated that job related issues contributed to their financial difficulties. This included unemployment, temporary or permanent layoff, and reduction in income from either a reduction in overtime or a cut back in total hours worked.

Again, if your lifestyle requires a certain income, and your income is reduced, credit is often used to make up the shortfall.

Medical Problems

Despite universal health care in Canada, 16% of our clients cited illness, injury, and health related problems as a cause of their financial difficulties.

Generally this is due to time off work recovering from their health problems. During their convalescence they may use credit to survive and pay their day to day bills. Once they return to work, they are left with more debt than they can handle.

In summary, for most people, financial problems are the result of some major life altering event. Certainly these people must assume responsibility for their insolvency, but in most instances, their financial problems are really a result of not planning for a “rainy day” and not because they set out to deliberately incur more debt.

Over Use of Credit

Access to consumer credit continues to grow in Canada.

Unfortunately the disposable income of Canadians has not kept pace with the growth in the level of household debt. In layman’s terms, Canadians’ spending is increasing faster than their incomes. It now takes more of each Canadian’s take-home pay to service the debt that they have accumulated. If anything interrupts the average person’s income, even for as little as a month or two, they find themselves unable to meet their obligations.

Ask yourself this question:

If I lost my job, how many paycheques would I need to miss before I experienced serious financial trouble?

Based on our experience, many Canadians are only one or two missed paycheques away from serious financial problems.

Household debt per person as a percentage disposal income reached an average of 128.8% in 2007, as compared an average level of 116.5% in the second quarter of 2005.

Clearly, if Canadians owe more than their annual disposable income, and the level of debt continues to increase, one obvious result is that the number of insolvencies each year will continue to increase.

4. How Can I Solve My Financial Problems?

When the professionals at Hoyes Michalos meet with "Joe Debtor", we present the following possible solutions to financial problems:

- **Work it out yourself**; reduce your monthly living expenses, and/or increase your monthly income (work overtime, get a part time job), and use the extra cash flow to pay off your debts.
- **Debt Consolidation Loan**; if you still have good credit, get a loan from your bank at a reasonable interest rate, and use it to pay off your high interest debts, like credit cards. Since more of your payment is being applied to principal, you may be able to get out of debt faster, provided you cut up your credit cards so you don't incur any new debt.
- **Credit Counselling**: a not-for profit credit counsellor can prepare a Debt Management Plan where you repay all of your debts in full over a two to five year period; most major banks and credit card companies will agree to waive interest payments when you participate in a Debt Management Plan.
- **Consumer Proposal**: if you can't afford to repay your debts in full, a consumer proposal is a great option to repay a portion of your debts and have the remainder of the debts discharged.
- **Bankruptcy**: the final option is personal bankruptcy to discharge your debts.

In Appendix D we compare the payments in a consumer proposal and a bankruptcy.

Each option has advantages and disadvantages, so it is important to review your options with a trained professional to decide on the correct option.

Appendix A: "Joe Debtor" – The Average Insolvent Debtor

Based on the Hoyes Michalos & Associates Inc. proprietary database of the individuals and families we have assisted during the period from August 1, 2006 to December 31, 2007, the "typical" debtor is as follows (more details can be found in Appendix B):

Personal Information:

Gender:	Male
Weighted Average Age:	42 years old
Total unsecured debt:	$51,106
Likelihood they own a home:	21% (1 in 5 of our debtors are home owners)
Average mortgage value:	$122,108 (for debtors with mortgages)
Average family size:	2 people (including the debtor)
Average monthly income	$2,071 net of deductions
Average net monthly income for all Canadians	$2,831 [3]

Detailed Information on the amount of average unsecured debt:

Bank Loans	$13,365
Credit Cards – Banks and Trust Companies	$10,750
Credit Cards – Other Issuers	$7,585
Taxes	$5,276
Finance Company Loans	$4,401
Student Loans	$1,532
Other debts	$8,197
Total unsecured debt	$51,106

See next page for details on debt owed to specific creditors.

Fast Facts on Debt

Credit Card Debt

- 93% of insolvent debtors owe money on credit cards, and the average debt they owe is $19,763
  - 76% of insolvent debtors owe money on credit cards to Canadian banks, and the average debt they owe is $14,202
  - 79% of insolvent debtors owe money on credit cards to non-Canadian banks (such as American credit card issuers, and retail store credit cards), and the average debt they owe is $9,653
  - 25% of insolvent debtors owe money to a popular Canadian hardware and Tire retailer, and the average debt they owe is $4,698
  - 46% of insolvent debtors owe money on American company credit cards (Amex, MBNA, Citibank), and the average debt they owe is $10,097
  - Therefore more debtors have non-bank credit cards than bank credit cards, but the amount they own on their cards remains larger with the Canadian banks.

Canada Revenue Agency Debt

- 37% of insolvent debtors owe money to Canada Revenue Agency, and the average debt they owe is $11,967

Finance Company and Pay Day Loan Debt

- 61% of insolvent debtors owe money to finance companies, and the average debt they owe is $4,938
- 12% of insolvent debtors owe money to payday loan companies, and the average debt they owe is $1,422

Estimated minimum monthly payments required to service their unsecured debt:

Bank Loans – mixed rate of 10%, plus 3% of loan balance repaid monthly	$512
Credit Cards – 19%, plus 2% of balance repaid monthly	$657
Taxes – 1% interest per month, 12 months to pay	$492
Finance Company Loans – mixed rate of 31%, plus 2% of loan balance repaid monthly	$202
Student Loans– mixed rate of 10%, plus 2% of loan balance repaid monthly	$43
Other debts – no set terms (assume 2% of debt repaid monthly, no interest)	$164
Total unsecured debt	$2,070

The minimum monthly payments noted above are almost equal to Joe Debtor's monthly income – this is true for a many of our debtors. Prior to filing, Joe will have sold whatever he owns, borrowed from whoever would lend him money and then started making and then immediately withdrawing his monthly payments in order to "spread" his paycheque as far as possible. This strategy will eventually result in either legal action and/or bankruptcy.

Appendix B: Typical Insolvent Debtor Profile

The following profile of a typical insolvent debtor is derived from the database of all debtors assisted by Hoyes Michalos & Associates Inc. during the period from August 1, 2006 and December 31, 2007.

Table 1: Gender of Insolvent Debtor

Gender	Distribution
Male	56%
Female	44%

Table 2: Age of Insolvent Debtor

Age	Distribution
20-30	19%
31-40	30%
41-50	28%
51-60	15%
61-70	6%
Over 70	2%

Weighted Average Age: 42 years old

Table 3: Marital Status of Insolvent Debtor

Marital Status	Distribution
Married or Common-Law	40%
Single	29%
Separated	18%
Divorced	11%
Widowed	2%

Table 4: Family Size of Insolvent Debtor

Household Size	Distribution
1	46%
2	20%
3	15%
4	12%
5	5%
6 or more	2%

Weighted average size is 2.16 persons per family. This may be a husband and wife, or also very common would be a single parent and a dependant child.

Table 5: Net Monthly Income – Debtor and Others in Household

Income	Debtor	Others
$NIL	4 %	68%
$1 - $1,000	11%	10%
$1,001 - $2,000	36%	11%
$2,001 - $3,000	33%	8%
$3,001 to $4,000	12%	2%
$4001+	4%	1%

Average income for the debtor is $2,071.

Average income for others in the household is $533.

Table 6: Causes of Insolvency

Causes of Financial Difficulty	Rate
Over extension of credit, financial mismanagement	40%
Job related (unemployment, layoff, reduction in pay)	33%
Unable to service debt (low income, business failure, other reasons)	22%
Marital or relationship breakdown	16%
Illness, injury, and health related problems	16%

This chart is a summary of the reasons given by the debtors on the Statement of Affairs, when asked to give reasons for their financial difficulties.

The numbers do not add to 100% since some debtors give more than one cause for their insolvency.

Appendix C: "Jane Student" – The Average Insolvent Debtor with Student Loan Debt

Based on the Hoyes Michalos & Associates Inc. proprietary database of the individuals and families we have assisted during the period from August 1, 2006 to December 31, 2007, the "typical" debtor with student loan debt has the following profile:

Personal Information:

Gender:	Female
Weighted Average Age:	36.6 years old
Total unsecured debt:	$48,660
Likelihood they own a home:	17%
Average family size:	2.2 people (including the debtor)
Average monthly income	$2,024 net of deductions
Average net monthly income for all Canadians	$2,831[4]
Average amount owed on student loans	$8,104

Table 7: Gender of Insolvent Student Loan Debtor

Gender	Distribution
Male	44%
Female	56%

Table 8: Age of Insolvent Debtor

Age	Distribution
20-30	28%
31-40	45%
41-50	19%
51-60	7%
61-70	1%
Over 70	0%

Weighted Average Age: 36.6 years old

Table 9: Marital Status of Insolvent Debtor

Marital Status	Distribution
Married or Common-Law	34%
Single	43%
Separated	13%
Divorced	10%
Widowed	0%

Table 10: Family Size of Insolvent Debtor

Household Size	Distribution
1	44%
2	20%
3	17%
4	12%
5	6%
6 or more	1%

Weighted average size is 2.2 persons per family. This may be a husband and wife, or also very common would be a single parent and a dependant child.

Table 11: Net Monthly Income – Debtor and Others in Household

Income	Debtor	Household
$NIL	4 %	2%
$1 - $1,000	11%	9%
$1,001 - $2,000	36%	29%
$2,001 - $3,000	33%	27%
$3,001 to $4,000	12%	18%
$4001+	4%	15%

Average income for the debtor is $1,818.

Average income for others in the household is $452.

Appendix D: Joe Debtor Comparison of Proposal to Bankruptcy

As an example, Joe Debtor is a married person, with no dependants (a family of two).

The average Hoyes, Michalos & Associates Inc. debtor has monthly income of $2,071, and other members of his family (a spouse, child or other dependent) have average monthly income of $533[5]. In a bankruptcy, Joe's surplus income would be calculated as follows:

Joe's income	$2,071	79%
Other family member's income	$533	21%
Total Family Income	$2,604	100%
OSB Threshold for family of 2	$2,286	
Surplus income	$318	
Payment required for family	$159	(50% of the total)
Joe's surplus payment	$126	(79% of the total)

In this example, Joe would be required to pay $126 per month for each month that he remains an undischarged bankrupt. In addition, most trustees require the bankrupt to make a minimum contribution to cover the costs of the administration of the estate (in the event that there was no surplus payment by the bankrupt). Assuming a typical minimum contribution of $160 per month, Joe's total payment would be $286 per month.

Table 12: Comparison of proposal to bankruptcy

Scenario	Joe's Payments	Dividend to Creditors
Nine month bankruptcy	$2,574	1.1%
21 month bankruptcy	$6,006	5.3%
Proposal: 48 months x $250	$12,000	14.5%

Notes:

1. Dividend to creditors is the projected rate of payments to the creditors based on the average unsecured debts of $51,106 after all costs of administration. For example, a 1.1% dividend on $51,106 in unsecured debts means the creditors have received a repayment of $562.

2. The average proposal filed by Hoyes Michalos & Associates Inc. in the past three years has a term of 47 months and a payment of $350, since in general proposals are filed by debtors with higher incomes than bankrupt debtors. In this example we have assumed terms of 48 months and $250 per month. This is a more realistic example of a proposal that the average debtor would file.

In the above example, Joe would pay $12,000 in a four year proposal at a rate of $250 per month, versus a bankruptcy under the proposed new rules of 21 months (for a first time bankrupt) at $286 per month for a total of $6,006.

It is possible that the creditors would accept a proposal of $250 per month for 36 months, as that will still provide a higher rate of return to Joe's creditors than the realizations in a bankruptcy.

For Joe, the proposal's main advantage is the certainty provided with the proposal payment. It will not change as his income fluctuates. In addition, while the total mount that Joe will be required to pay in the proposal is significantly higher than the amount he would pay to pay if he filed bankruptcy, the actual monthly payment is significantly lower – effectively making the proposal easier to manage for Joe. Finally, Joe may feel better about himself for having not filed bankruptcy.

Appendix E: A Typical Sequence of Events Leading to Bankruptcy

The following provides an example of the downward spiral leading to personal bankruptcy. It is based on our years of professional experience and as such is a composite of many of the stories we hear every week in our professional practice:

- Joe Debtor calls our office, obviously distressed because he cannot handle his monthly payments. He starts by telling us his story - he may have experienced a marital breakdown, perhaps he was off work due to illness, or perhaps his employer of many years has closed up shop. Regardless, something has happened that caused a reduction in income for Joe and he did the following:
- First, he used up what little savings he had and/or sold the things that he could easily turn into cash to pay his bills.
- Next, he used his credit cards based on the assumption that things will get better if he can only make it through the next couple of months. Often at this stage Joe will receive a new "gold card" application in the mail promising him $5,000, $10,000 or even $50,000 in new credit. Joe is sure things will improve so he takes the new card.
- Things don't improve and so now he cashes out his RRSPs or sells other assets he still has in order to raise more money to service his debt. If he's able to do this he has created a short term solution with longer term implications, not the least of which is that he will probably owe the Canada Revenue Agency additional taxes by converting his registered investments into cash.
- Next he starts looking for loans or lines of credit to consolidate his debt. If he's fortunate, he might still qualify for a loan at a major financial institution. Unfortunately, by this point most of the banks and other major lenders will not extend Joe any additional credit.
- Joe still feels he can borrow his way out of trouble and so he turns to the higher risk (and therefore higher interest) lenders. They are pleased to extend Joe credit provided he will agree to 29% to 33% interest on the debt, and perhaps pledge his car as security.
- Three or four months later, perhaps longer if Joe is good at juggling his payments, Joe comes to realize that he is in too deep and starts looking for other solutions. In many cases the solution Joe settles on is to file personal bankruptcy.
- This is not the end of the story. When Joe speaks to his trustee he learns that because Joe pledged his car as collateral to the finance company, that particular debt may not be discharged (eliminated) by his bankruptcy unless he surrenders his car. If Joe wants to keep his car he will have to make arrangements with the finance company to continue servicing this debt.
- Instead of a fresh start, Joe is left with one of his most expensive debts, with no relief in sight. The cycle of indebtedness has begun again.

Endnotes

[i] PDI per adult (18+) average for the 3 quarters ended Sept 2007 was $33,983, or $2,831 per month. Source: PDI current per quarter (CANSIM: Table 384-0004, [D14914], v498186) divided by estimated population 18+ per quarter. Estimated adults population per quarter equals population per quarter (CANSIM: Table 051-0005, [D1]) times the % of population annually that is 18+ (CANSIM: Table 051-0001, v466677 / CANSIM: Table 051-0001, v466668).

[ii] Household credit per adult (18+) for the third quarter 2007, less mortgages, was $13,801. We have calculated this as household credit for the third quarter (CANSIM :Table 176-0032, [B166], v36415 (avg)) divided by estimated population 18+ per quarter. Estimated adults population per quarter equals population per quarter (CANSIM: Table 051-0005, [D1]) times the % of population annually that is 18+ (CANSIM: Table 051-0001, v466677 / CANSIM: Table 051-0001, v466668).

[3] PDI per adult (18+) average for the 3 quarters ended Sept 2007 was $33,983, or $2,831 per month. Source: PDI current per quarter (CANSIM: Table 384-0004, [D14914], v498186) divided by estimated population 18+ per quarter. Estimated adults population per quarter equals population per quarter (CANSIM: Table 051-0005, [D1]) times the % of population annually that is 18+ (CANSIM: Table 051-0001, v466677 / CANSIM: Table 051-0001, v466668)

[4] PDI per adult (18+) average for the 3 quarters ended Sept 2007 was $33,983, or $2,831 per month. Source: PDI current per quarter (CANSIM: Table 384-0004, [D14914], v498186) divided by estimated population 18+ per quarter. Estimated adults population per quarter equals population per quarter (CANSIM: Table 051-0005, [D1]) times the % of population annually that is 18+ (CANSIM: Table 051-0001, v466677 / CANSIM: Table 051-0001, v466668)

[5] Note: Our average bankrupt's family has two people. In a majority of cases the second person has no income.