
HOYES • MICHALOS

& ASSOCIATES INC. – TRUSTEES IN BANKRUPTCY

The “Face” of Bankruptcy
Revealing the Typical Insolvent Person

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1. Executive Summary

Hoyes, Michalos & Associates Inc. is a trustee in bankruptcy firm headquartered in Kitchener with 14 offices throughout Ontario, from Windsor through Toronto. We specialize in personal insolvency work (bankruptcies and proposals).

On June 3, 2005 the government of Canada introduced a series of bankruptcy reforms as part of Bill C-55¹. We have prepared this study, and submitted its results to the House of Commons Committee² studying this legislation. Our purpose was to give the legislators a picture of the average insolvent person³, so that they may more fully understand how these proposed changes will impact on the average insolvent person.

An analysis of all of our clients since the beginning of 2002 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, 40.5 years old. He has one dependent living with him, either a spouse or a child. His take home pay is about \$2,400 a month. He owes the major banks more than \$30,000 for loans, lines of credit and credit cards. He owes other credit card companies (department stores and US credit cards that now operate in Canada) another \$6,200. He owes the government more than \$6,000 and he is likely dealing with finance companies and payday loans for around \$4,000 more. His total unsecured debt is more than \$50,000.

Our study shows that 33% of these individuals stated that lay-off or reduced incomes contributed to their financial problems, and 29% are either separated or divorced.

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.

2. The Typical Insolvent Person

On June 3, 2005 the federal government introduced Bill C-55, *An Act to establish the Wage Earners Protection Program, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*.

This new legislation, if passed, will require individuals with significant monthly income to contribute more to their creditors during the bankruptcy process.

After carefully reading the proposed legislation we questioned whether the requirement to make increased payments when someone files bankruptcy is a response to the public's perception that a bankrupt is "down and out, unemployed" and trying to beat the system.

Hoyes, Michalos & Associates Inc. is a trustee in bankruptcy firm headquartered in Kitchener with 14 offices throughout Ontario, from Windsor through Toronto. We specialize in personal insolvency work (bankruptcies and proposals).

In 2001 we developed a proprietary database that enables us to track and analyze the information in our files for all of our clients. Based on an analysis of this data, 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 profile of our debtors).

Our study reveals that the image that most people have of a bankrupt person is not valid. Instead of being unemployed and on social assistance, as many people think, most insolvent persons are employed with a reasonable income:

- 54% of all bankrupts are male; 46% are female.
- Their average age is 40.5 years, (although we have handled files for people in their early twenties up through age 80 and beyond).
- 37% are married, 32% are single, and 31% are either separated, divorced or widowed.
- 49% live alone, but the average family size is two, which typically includes the debtor and a dependent spouse or child.
- On average they owe more than \$50,000 in unsecured debt to banks, credit card companies, finance companies, and Canada Revenue Agency.

The stereotype is dispelled by the fact that the average take home pay for the typical insolvent debtor is more than \$2,400 per month, indicating that they are working and productive members of society.

In fact, 20% of our clients own a home and have a mortgage when they file.

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 clients 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 it 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; they 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.

According to the Canadian Banker’s Association, in 2004 there were more than 53 million Visa and Mastercards in circulation in Canada, as compared to 27.5 million in 1994⁴. Net retail spending using credit cards has grown to almost \$169 billion, as compared to \$55 billion in 1994.⁵

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.

Household debt per person as a percentage disposal income reached an average of 111.6% in 2004, and grew to 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 continues to increase.

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 over the past three years, the “typical” debtor is as follows (more details can be found in Appendix B):

Personal Information:

Gender:	Male
Weighted Average Age:	40.5 years old
Total unsecured debt:	\$50,755
Likelihood they own a home:	20% (1 in 5 of our clients are home owners)
Average mortgage value:	\$134,432
Average family size:	2 people (including the debtor)
Average monthly income	\$2,419 net of deductions

Detailed Information on the amount of their unsecured debt:

Major Canadian banks	\$ 30,645 including loans, lines of credit and credit cards
Other major credit cards	\$ 6,210
Canada Revenue Agency	\$ 6,020 (note that 51% of our clients have debts with CRA, the average debt is \$11,770 for those that do)
High interest lenders	\$ 3,824 (note that 50% of our clients have debts to high interest lenders, the average debt is \$7,694)
Other unsecured debt	\$ 4,056 (miscellaneous debtors)

Estimated minimum monthly payments required to service their unsecured debt:

Major Canadian banks – mixed rate of 13.5%	\$1,264
Other major credit cards – 18.99%	285
CRA – 1% interest per month, 12 months to pay	562
High interest lenders – mixed rate 31%	127 (\$98 is interest)
Other unsecured debt – no set terms	<u>100</u>
Total minimum payments each month	<u>\$2,338</u>

The minimum monthly payments noted above are almost equal to Joe Debtor’s monthly income – this is true for a many of our clients. 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 served by Hoyes Michalos & Associates Inc. in the last three years:

Table 1: Gender of Insolvent Debtor

Gender	Distribution
Male	54%
Female	46%

Table 2: Age of Insolvent Debtor

Age	Distribution
18-30	22%
31-40	31%
41-50	26%
51-60	15%
Over 60	6%

Weighted Average Age: 40.5 years old

Table 3: Marital Status of Insolvent Debtor

Marital Status	Distribution
Married	37%
Single	32%
Separated	15%
Divorced	14%
Widowed	2%

Table 4: Family Size of Insolvent Debtor

Household Size	Distribution
1	49%
2	22%
3	15%
4	12%
5 or more	2%

Weighted average size is 2.0 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	5 %	66%
\$1 - \$1000	11%	11%
\$1001 - \$2000	41%	16%
\$2001 - \$4000	40%	7%
\$4001+	3%	0%

Average income for the debtor is \$2,418.91.

Average income for others in the household is \$537.80.

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: 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 maybe \$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. In addition, the finance company representative tells Joe they require a list of his household goods “for insurance purposes”. Joe, proud of his remaining possessions, gives them a complete list of his household goods, not realizing that he is signing a document that gives the finance company the right to put a lien on his belongings. Not realizing what he is doing, Joe agrees to whatever terms they require in order to qualify for the loan.
- 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 personal possessions and furnishings as collateral to the finance company, that particular debt may not be discharged (eliminated) by his bankruptcy. If Joe wants to keep his possessions 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

¹ Further information can be found on the hoyes.com web site at <http://www.hoyes.com/bankruptcy-reform.htm>

² The House of Commons Standing Committee on Industry, Natural Resources, Science and Technology; further information on the Committee's activities can be found at <http://www.parl.gc.ca/committee/CommitteeHome.aspx?Lang=1&PARLSES=381&JNT=0&COM=8983>

³ We use the term “insolvent debtor” in this study instead of the term “bankrupt”, because “insolvent debtor” refers to both bankrupts and debtors who file proposals as an alternative to bankruptcy. Information on consumer proposals can be found at <http://www.hoyes.com/proposals.htm>

⁴ Source: Canadian Banker's Association: <http://www.cba.ca/en/content/stats/050210-Credit%20cards-EN.pdf>

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