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& ASSOCIATES INC. – TRUSTEES IN BANKRUPTCY

Report to the Standing Senate Committee on Banking, Trade and Commerce

The Present State of the Domestic and International Financial System:

Bankruptcy and Insolvency

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1. Executive Summary

Hoyes, Michalos & Associates Inc. is a professional services firm that has provided personal insolvency services to individuals in Ontario since 1999. We are one of the largest firms in Canada practicing exclusively in the area of personal insolvency. During the preparation of this document we have analyzed and summarized detailed data obtained from our database of actual debtor information, and therefore we believe that our conclusions are based on "real world" data and experience.

We are generally supportive of the changes contained in Bill C-55 from 2005, and Bill C-12 from 2007, however we believe there are some specific areas requiring amendment during the next round of legislative review. We have the following recommendations, which are explained in detail in the body of this report:

- The time limit for the inclusion of student debt as dischargeable debts in bankruptcy should be reduced to two years.
- The new requirement for a discharge hearing for bankrupts with $200,000 or more in tax debt, where that debt represents 75% or more of their total debt, should be repealed.
- CRA should issue a policy paper explicitly stating the circumstances under which they will not accept a proposal. This may include cases where the debtor has not filed all statutorily required returns, preventing CRA from making an accurate assessment of the debt owing.
- The federal government should co-ordinate the approach to proposals between the Office of the Superintendent of Bankruptcy and the Canada Revenue Agency. It is inconsistent to have one agency promoting proposals, while another Agency starts with the assumption that they will be voting against proposals unless they will be receiving repayment of the full principal owing.
    - If necessary, standard clauses should be added to consumer proposals making it an event of default if tax returns are not filed as statutorily required during the term of the proposal.
- We recommend than when the new amendments are proclaimed into force, representatives of the OSB and perhaps the trustee community hold a series of information sessions for the large creditor groups, including CRA, to inform creditors of Parliament's desire to increase the number of proposals filed, and that all creditors should be encouraged to support proposals where practical.
- We support the new surplus income rules, but recommend that to ensure the new rules are applied consistently *Directive 11R* should be expanded to include specific directions to trustees requiring income to be verified on a monthly basis during the bankruptcy period.
- We strongly support the adoption of the amendment to increase the debt limit for filing Consumer Proposals to $250,000.

2. *Introductory Comments*

We would like to thank the Standing Committee for taking the time to consider our submissions regarding future insolvency reform.

We realize that 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,* has passed and has been given Royal Assent, but we also understand that this Committee intends to complete it's review of insolvency legislation in Canada with a view to suggesting changes for future revisions to the *Bankruptcy & Insolvency Act* and related statutes. To that end we are pleased to appear before the Committee to provide our 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 our report will focus on the area of personal insolvency reform.

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.

A great deal of emphasis has been placed on the Wage Earner Protection provisions of the new law, and while important, these provisions will affect, at most, 15,000 Canadians per year. Approximately 100,000 Canadians file a bankruptcy or proposal each year, so including dependents, the rules in the *Bankruptcy & Insolvency Act* directly affect more than 200,000 Canadians each and every year. That is a significant number of people, and therefore we strongly believe these amendments are very important to real Canadians.

We believe that there are two principle objectives of the *Bankruptcy & Insolvency Act*.

The first is to bring about the rehabilitation of the honest but unfortunate debtor by discharging their debts and providing them with the skills necessary to avoid financial problems in the future.

The second purpose is to provide for the orderly and fair distribution of the bankrupt's property to their creditors, or maximizing the funds distributed to the creditors.

In our opinion the emphasis of the amendments contained in Bills C-55 and C-12 are more consistent with the *Act's* second purpose, increased realizations for creditors, and less targeted towards the rehabilitation of the honest but unfortunate debtor. We base this conclusion on the fact that the majority of the amendments focus on reducing administrative costs while extending the period of repayment for persons with higher incomes. When we looked for amendments that will directly improve the process for the individuals that file bankruptcy, the only obvious ones we could find were the new exemption for certain RRSPs, and the increased debt limit on consumer proposals (which we strongly support).

As trustees who meet with "honest but unfortunate debtors" every day, we find this trend troubling, and in this report we will present our views on how this imbalance can be corrected.

We find this approach troubling because we believe that bankruptcy should be filed only after all other options have been considered and exhausted. Bankruptcy should not be used as a collection tool for creditors, or as a means for students to retroactively fund their education. We will comment on these issues later in this report.

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 the period from August 1, 2006 to 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*). We believe this information may help the Committee to better understand and appreciate the implications of their work.

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 $51,000 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[1] 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[2] 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.

Themes of the Proposed Amendments

In our opinion, the proposed amendments appear to support two overall themes.

The first and more dramatic is a definite trend to 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.

The second and perhaps less obvious theme seems to be a streamlining of the system; a movement away from Court approvals and review, and a higher degree of regulation (and therefore standardization) of how individuals within the system will be treated, as for example in the new standard "21 month" bankruptcy discussed above.

We are generally supportive of both of these themes, but we note that there appears to be a lack of balance in the proposed amendments. 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.

We are referring specifically to Canadians that are unable to repay their student loans, but we will also provide our comments on the many Canadians that want settle with their creditors by filing a consumer proposal, but cannot successfully do so due to the current legislative and business environment.

The pages that follow deal with our specific comments and concerns regarding Bill C-55 (now Statutes, Chapter 47) and Bill C-12. Once again, we would like to thank the Committee for taking the time to consider our submissions.

3. Comments and Suggested Changes to Future Insolvency Legislation

A. Reduction in the Student Loan Discharge Period

We recommend that the time limit for the inclusion of student debt as dischargeable debts in bankruptcy be reduced to two years.

The amendment to the *Bankruptcy & Insolvency Act* as passed in Bill C-55 in 2005 is as follows:

> **107.(2) subparagraph 178(1)(g)(ii) of the Act is replaced by the following:**
>
> **"(ii) within seven years after the date on which the bankrupt ceased to be a full-time or part-time student; or…."**

Under the legislation currently in force, student loans are not dischargeable in bankruptcy if the bankruptcy occurs within ten years of the date on which the bankrupt individual ceased to be a student. The amendment as passed in Bill C-55 in November 2005 (now Chapter 47, Statutes of Canada) reduces the waiting period to seven years.

We appreciate the unique nature of student loan debt. We understand that the knowledge and skills learned in school remain with a student for life, and therefore it may not be fair to simply allow student loans to be discharged with no time restrictions. (We don't fully agree with this position, and have included our more detailed comments in Appendix E).

While we appreciate the unique nature of student loans, we do not believe the amendment as passed in 2005 is sufficient to correct the imbalance in the legislation.

Most stakeholders are in agreement that the ten year restriction was too long – our purpose is to try and convince the committee that a change to seven years is still too long, as is five years or even three.

We support a reduction to a waiting period of **two years**, for the following reasons.

First, the cost of post secondary education continues to increase. Canadian full-time undergraduate students are paying an average of $4,524 in tuition fees for the 2007/2008 academic year, up from the $1,185 they paid in 1988/89.[3] Additional compulsory fees averaging $603[4] per year increase the cost of undergraduate education to over $5,100 per year, not including living expenses. This increased burden on students increases the need for students to obtain student loans to complete their education.

Second, more than half of university students accumulate some debt over the course of their university education.[5]

> *Living away from home and not receiving funding from family are strong predictors of student debt. Both of these variables are factors over which students have little or*

no control – they may be forced to live independently, and they cannot dictate how much financial assistance their parents will provide them to support their education.[6]

Based on our personal experience, the vast majority of debtors with student loan debts did not want to incur debt while in school, but they had few other options to complete their education.

Over 30% of university students are carrying more than $20,000 in debt, and the average university student with debt owes over $24,000.[7]

Clearly it is a burden to graduate into an entry level job and to then be required to make repayment arrangements on $24,000 in debt.

We have analyzed the data from the individuals who have filed bankruptcies and proposals with our firm, and we present the details in Appendix C, using "Jane Student" to illustrate the plight of the average insolvent student loan debtor. 13% of our debtors have student loan debts (as compared to 12% of all Canadians[8]). The profile of one of those people is as follows.

Jane Student is female, 36.6 years old. (56% of our student loan debtors are female, as compared to only 44% of all insolvent debtors; "Joe Debtor" was 42.8 years old).

She owes $8,104 in student loans at the time of filing (as compared to a median student loan value of $9,000 for all Canadian families[9]). That is a large loan balance, since Jane Student will typically wait 10 years to declare bankruptcy, and during those ten years she has had her tax refund seized to pay the student loans, and she has made payments on her loan when possible.

Where student loans represent more than 50% of their total debt, Jane's net income at the time of filing is $1,818 per month, as compared to $2,071 for all persons filing a proposal or bankruptcy. In other words, significant student loan debtors have incomes 12% less than all insolvent debtors.

Even worse, the average Canadian adult has take home income of $2,831 per month, so the average insolvent debtor with student loan debt has income 56% less than the average Canadian.[10]

What can we learn from Jane Student?

An insolvent debtor is just as likely to have a student loan as is the average Canadian, and Jane Student has a student loan approximately equal in size to the average Canadian family. The difference is that Jane Student earns considerably less than the average Canadian.

Insolvent persons with student loans have student loans because, in general, they had no other option for funding their education, and they tend to be:

- younger;
- disproportionately female; and
- have lower incomes

as compared to the average insolvent person.

As we stated earlier, the bankruptcy process should not be a substitute for inadequacies in other government programs. If students could attend school without the need to finance their education with excessive student loans, students would not need to avail themselves of the bankruptcy process to deal with their student loan debts.

Recommendation:

We therefore conclude that this segment of the insolvent population truly are "honest but unfortunate debtors" in need of a "fresh start", and therefore we recommend that student loans be automatically discharged in a bankruptcy after two years.

B. Canada Revenue Agency Debts

We recommend that the amendment requiring a discharge hearing for bankrupts with $200,000 or more in tax debt, where that debt represents 75% or more of their total debt, serves no useful purpose, and should be repealed.

It appears that one of the goals of the recent amendments to the *Bankruptcy and Insolvency Act* was to decrease administrative costs and involvement of the creditors, while at the same time increasing their returns by extending the periods of repayment for persons filing bankruptcy.

As the Canada Revenue Agency is a creditor in approximately 37% of our debtor's files, these amendments directly benefit the Agency.

Upon a cursory review, there is only one amendment in the new legislation that is aimed directly at persons with debts to the Canada Revenue Agency (CRA). That is the requirement for bankrupts with tax debt in excess of $200,000 representing 75% or more of their total debt to appear in Court and explain the circumstances that lead to their tax debt.

Initially we did not perceive this as a significant amendment. Of the 3,000 individuals and families we will assist this year, this new rule will apply to perhaps four or five people. Frankly, it seemed a strange amendment to create.

Under existing legislation, any creditor, including CRA, has the right to oppose a bankrupt's discharge and request a hearing. With this new amendment, CRA will not need to oppose a large tax debtor's discharge, so this amendment has the effect of automating that process from the perspective of CRA. The bankrupt's discharge is opposed, with no effort required by CRA. While no additional effort will be required by CRA, the bankrupt, the Court and the trustee will now be required to participate in a discharge hearing. In effect, CRA is requiring the Court to review any cases of unusually large tax debt without CRA having to go to the trouble of requesting a court hearing to present their objections.

We have no inside knowledge of how this amendment came into being, but from our outsider's point of view it appears that CRA has lobbied to have this provision included so that they do not need to review bankruptcies and decide, on the individual merits of the case, whether or not a discharge hearing is appropriate.

Instead of requiring CRA to review each case, it will now be up to the court to determine what actions are appropriate.

In practice, it is very unusual for CRA to oppose a discharge, since we understand it is administratively difficult for CRA to have counsel from the Justice Department appear at a discharge hearing.

This new rule will obviously create more discharge hearings than currently exist, however, since presumably CRA will continue their current practice of not appearing at discharge hearings, the Court will now be placed in the un-enviable position of having to assume what CRA would have said had they been there. Without CRA's opinions, it is likely the Court will take no additional action, so the discharge hearing will serve no ultimate purpose.

There will be extra time spent by the Courts, the trustee, and the bankrupt, but no purpose will be served by this amendment.

We have three other concerns with this amendment.

First, is this $200,000 rule the first in a series of successive amendments that will gradually reduce this limit? Will the next round of amendments reduce the limit to $100,000 or $50,000? For this amendment to apply to more than a small handful of bankrupts each year, CRA will want the limit to be much lower.

Second, to be equitable and fair to the entire body of creditors, should this automatic opposition rule not also apply to other large debts? Why is this a CRA rule, instead of a rule that applies to all classes of debt? If a bankrupt owes $200,000 on various credit cards, should the Court not also scrutinize the circumstances of that debt? It would appear that this is a CRA rule only, because only CRA had the influence to have this rule included in the legislation.

Third, requiring discharge hearings for large tax debtors, combined with the new rules that extend a bankruptcy to 21 months where surplus income is present, may have the effect of reducing the number of proposals CRA is willing to accept, since a bankruptcy is now much more punitive than a proposal, as discussed in the next section.

C. Proposals

We recommend that all creditors, including CRA, be advised of Parliament's desire to increase the number of proposals filed, and that all creditors should be encouraged to support proposals where practical.

We believe that one of the objectives of Bill C-55 and Bill C-12 is to encourage debtors to file a proposal instead of filing a bankruptcy. We base this assumption on the new requirement for a bankruptcy to extend for 21 months where surplus income exists, thereby encouraging debtors to file a proposal to avoid a now longer and more costly bankruptcy. The new limit of $250,000 in debt will also encourage more debtors to file consumer proposals. We support that objective, as we believe that proposals are a good way in many cases to bring about the "rehabilitation of the honest but unfortunate debtor."

Proposals have a number of advantages over bankruptcies, including:

a. Proposals result in a higher percentage of repayment of a person's unsecured debts;

b. Proposals are less complicated to administer, resulting in a more efficient use of limited government resources (at the OSB and in the Courts);

c. Proposals are less expensive to administer which means that a greater portion of the funds collected will be used to repay a person's unsecured debts; and

d. Debtors often feel better about themselves and their situation if they can avoid bankruptcy.

CRA and Proposals

Presently, for every six bankruptcies that are filed in Canada there will be one proposal filed. In Ontario that ratio is five to one and in our own practice it is two to one. For every two bankruptcies that are filed by our offices we file one proposal.

Our clients are not any different from the average insolvent person – the difference lies in our approach to resolving an individual's financial problems. We always consider and discuss the merits of a proposal before we allow a debtor to consider an assignment in bankruptcy.

As result of this bias towards proposals we have a unique perspective on how different creditors consider proposals. Most use what we call a common sense approach – will the proposal result in a greater rate of return to the creditor than an assignment in bankruptcy? If the answer is yes then most creditors vote in favour of a proposal.

Under the new rules, however, even if CRA votes no, in the case of a debtor with surplus income they are now guaranteed payments for 21 months, so the difference between realizations in a proposal and a bankruptcy has been reduced.

This leads to the somewhat bizarre situation where one agency of the federal government, Industry Canada, is encouraging proposals, while another agency of the federal government, CRA, is discouraging proposals by voting against what would otherwise be considered a viable proposal.

We appreciate CRA's unique position as a creditor. The debtor did not apply for a loan from CRA, and unlike a bank that can make a lending decision, CRA did not choose to be a creditor. We also understand that CRA has a responsibility to treat all Canadian taxpayers fairly, and cannot be perceived to be "going easy" on delinquent debtors. Finally, we acknowledge that if a taxpayer has, in the past, actively avoided their tax obligation by not filing tax returns in a timely manner, and by not making a concerted effort to make payments, it is difficult for CRA to ignore the debtor's past filing history and accept a proposal for less than the full amount owing.

However, the bankruptcy process exists to rehabilitate the honest but unfortunate debtor, and to ensure the fair and equitable distribution of the bankrupt's property to the creditors. The bankruptcy process should not be used as a collection tool for Canada Revenue Agency or any other creditor.

If a taxpayer has been permitted to accumulate significant tax debts the solution to that problem does not rest with the insolvency system. In our experience, very few Canadians accumulate large tax debts overnight – they take years to develop. The time to correct the problem is as soon as it can be discovered, not years later.

While we do not pretend to be experts in the tax system, we submit that if tax debts are an increasing problem, CRA should be given the resources and direction to contact taxpayers as soon as a liability is assessed, and even contact taxpayers proactively if statutory returns have not been filed in a timely manner, so that problems can be addressed before they grow and necessitate a bankruptcy filing as a solution.

If collection practices are modified, the result may be fewer tax debtors, and therefore a reduced need to deal with tax debts through bankruptcies and proposals.

We recommend that CRA issue a policy paper explicitly stating the circumstances under which they will not accept a proposal. This may include cases where the debtor has not filed all statutorily required returns, preventing CRA from making an accurate assessment of the debt owing.

CRA is responsible for maintaining the integrity of the tax system, but they are also a creditor responsible for generating the maximum realizations on behalf of the Canadian taxpayer, and we believe both responsibilities should be considered when deciding on the acceptance or rejection of a proposal.

An opening negotiating position of requesting 100 cents on the dollar will bias their votes against many otherwise viable proposals.

In fact, we have dealt with numerous debtors who were willing and able to file proposals, but the proposals were rejected, they filed bankruptcy, and the creditors received significantly less than they would have received had they accepted the proposal.

Unfortunately the Agency's policy disregards the fact that a well drafted proposal will result in a higher rate of repayment than a bankruptcy, and therefore in most cases it is to the benefit of all creditors to accept most proposals. Agency staff, bound by head office policy, are left with little option except to reject many reasonable proposals to the detriment all unsecured creditors.

By rejecting proposals, all creditors receive less money.

Recommendation: The federal government should co-ordinate the approach to proposals between the Office of the Superintendent of Bankruptcy and the Canada Revenue Agency. It is inconsistent to have one agency promoting proposals, while another Agency starts with the assumption that they will be voting against proposals unless they will be receiving repayment of the full principal owing.

If necessary, standard clauses could be added to consumer proposals making it an event of default if tax returns are not filed as statutorily required during the term of the proposal, to satisfy some of CRA's objections.

Creditors Other Than CRA in Proposals

While it may be outside the purview of this Committee, we believe that all creditors should be encouraged to support proposals as an alternative to bankruptcy where appropriate.

We are in favour of amending the *Act* to make proposals more attractive, but if the major creditors are not supportive of this initiative then there will not be any significant changes in filing patterns. We can only hope that the banks and other major creditors believe in the value of these changes and will modify their own policies to be supportive of these measures.

It has been our experience that different creditors have different policies toward proposals.

Some creditors, such as certain finance companies and some credit unions, will reject virtually all proposals.

Other creditors, including a large Canadian chartered bank, will typically only vote in favour of a proposal if the projected dividend rate is greater than 25%, even if a bankruptcy would only provide a nominal return.

We assume that the Office of the Superintendent of Bankruptcy (the "OSB") will be holding a series of information sessions for the trustee community to explain how they will be interpreting the new rules.

We recommend than when the new amendments are proclaimed into force, representatives of the OSB and perhaps the trustee community hold a series of information sessions for the large creditor groups, including CRA.

These sessions could be an opportunity to explain both the new rules, and the goals of these rules. Perhaps if creditors understand that in most cases they can recover more money in a proposal than in a bankruptcy, the rate of acceptance of proposals will increase.

D. Debtors Will Be Required to Repay a Greater Portion of Their Debts

We support these amendments, if they are applied consistently.

Based on our analysis of the proposed amendments to the *Act*, it appears that a great deal of emphasis is being placed on requiring debtors to repay a greater portion of their debts than they have been required to repay under the existing legislation, if they have the economic means to do so.

We base this conclusion on the amendments that extend:

- a first time bankruptcy from the basic nine month period to 21 months if the bankrupt has "surplus income"[11];
- the period a person remains bankrupt for a second bankruptcy to 24 months. The current standard varies by province and region from as little 3 months up to 12 months or more;
- a second time bankruptcy to 36 months for individuals that have surplus income.

The impact of each of these amendments is to extend the required period of time for a person to make contributions (payments) into their bankrupt estate. The current legislation allows a trustee to recommend that a person's bankruptcy be extended, but this requirement is not consistently enforced.

Existing Practice

Surplus income arises from the application of Section 68 of the *Bankruptcy & Insolvency Act*, and the method of calculation of surplus income is detailed in Directive 11R, *Surplus Income*.[12]

Unfortunately, Directive 11R is not specific as to how frequently this calculation is to be performed. Paragraph 6(1) of the Directive reads as follows:

> 6. (1) In order to apply the Superintendent's standards (Appendix A), the bankrupt shall first complete the income and expense statement of the family unit, including the bankrupt, in Form 65 entitled *Monthly Income and Expense Statement of the Bankrupt and the Family Unit and Information (or Amended Information) Concerning the Financial Situation of the Individual Bankrupt.*

In other words, prior to the start of the bankruptcy, the bankrupt will provide the trustee with proof of their family income **at the date of bankruptcy**, and those income numbers are used to determine the amount of surplus income payments required during the bankruptcy.

For example, if at the start of the bankruptcy the trustee calculates that the bankrupt will be required to pay $200 per month on account of surplus income, the bankrupt could make those payments to the trustee each month, with no further proof of income required.

This approach may be unfair in many cases. For example, if the bankrupt's income changes in the second month of the bankruptcy, the trustee is unaware of the change if income is not being reported and proven to the trustee each month. As a result, if the

bankrupt’s income has dropped, they may be making unmanageable payments to the trustee. If their income has increased, they are not paying a sufficient amount, which reduces the proceeds to the creditors.

Paragraphs 11 and 12 of the Directive attempt to address the issue of irregular income:

> 11. When a bankrupt's income is irregular (e.g., sale commissions or seasonal employment), the amount that the bankrupt is required to pay to the bankrupt's estate may be deferred until the time of preparation of Form 82 entitled *Report of Trustee on Bankrupt's Application for Discharge*, if necessary. At that time, the average income for the period of bankruptcy would be considered for the purpose of determining the amount that the bankrupt is required to pay to the bankrupt's estate and a conditional discharge shall be recommended by the trustee for the total amount, if this has not already been paid.
>
> 12. The trustee shall comment on this situation when dealing with surplus income in Form 82 entitled *Report of Trustee on Bankrupt's Application for Discharge.*

In simple terms, if the bankrupt does not earn the same amount of money each month, the trustee can wait until the end of the eighth month of bankruptcy, at which time they are required to prepare Form 82 entitled *Report of Trustee on Bankrupt's Application for Discharge*, at which time the amount of surplus can be calculated.

In practice, the majority of bankrupts have “irregular” income. They work in a job where they are paid by the hour, and as their hours fluctuate, so to does their monthly income. Many bankrupts are paid weekly, so in most months they have four paycheques per month, but in four months of the year they have five paycheques, which increases their income, making it “irregular”. The same is true of employees paid bi-weekly, who can have two or three paycheques in any given month.

In our opinion, the proper method for assessing monthly income is to require the bankrupt to provide proof of income each month to the trustee, so that each month the trustee can adjust their required surplus income payment based on their actual income for the month.

In practice, some trustees require proof of income each month from their bankrupts, while others simply estimate it at the start of the bankruptcy.

These approaches have profound implications for the decision the insolvent debtor must make when deciding whether or not to file a proposal or bankruptcy.

If a debtor hopes that their income will be increasing and the trustee will adjust upward their required surplus income payments accordingly, they are more likely to choose to file a consumer proposal with payments based on their current income. However, if that same debtor knows that the trustee will not factor in any increases in income, they are more likely to file a bankruptcy, resulting in lower payments for them, and reduced realizations for the creditors.

This is of course a much more important issue now that a first time bankruptcy will automatically last for 21 months *if the bankrupt has surplus income*.

We therefore believe that all trustees should enforce the surplus income consistently. There are two possible approaches:

1. Surplus income is determined at the start of the bankruptcy, and is not verified on a monthly basis; or
2. Surplus income is estimated at the start of the bankruptcy, but is recalculated each month based on the bankrupt's actual proven family income each month, and the payments required are adjusted on a monthly basis to reflect actual income.

The second approach requires more effort on the part of trustees, but it results in a more equitable process, and greater realizations for the creditors. It also increases the likelihood that a debtor will choose to file a proposal instead of a bankruptcy if they expect their income to increase in the future.

Recommendation: *Directive 11R* should be expanded to include specific directions to trustees requiring income to be verified on a monthly basis in a bankruptcy.

Specifically, we would replace the current paragraph 11, which reads as follows:

> 11. When a bankrupt's income is irregular (e.g., sale commissions or seasonal employment), the amount that the bankrupt is required to pay to the bankrupt's estate may be deferred until the time of preparation of Form 82 entitled *Report of Trustee on Bankrupt's Application for Discharge*, if necessary. At that time, the average income for the period of bankruptcy would be considered for the purpose of determining the amount that the bankrupt is required to pay to the bankrupt's estate and a conditional discharge shall be recommended by the trustee for the total amount, if this has not already been paid.

With a new paragraph 11 as follows:

> 11. The bankrupt is required to provide proof of family income to the trustee for six consecutive months at the start of the bankruptcy period, and the bankrupt is required to pay to the bankrupt's estate a portion of their surplus income as defined in this Directive based on that income. The surplus for the first six full months of the bankruptcy will be reported by the trustee on Form 82, *Report of Trustee on Bankrupt's Application for Discharge*, and the bankrupt will be required to pay an amount equal to their average monthly surplus income each month during the duration of the bankruptcy.

Consistent Enforcement of Surplus Income Provisions

In current practice it is left to the discretion of the trustee to determine if a bankruptcy, due to surplus income, should be extended past the minimum nine month period, and if so, for how long.

Our practice covers Ontario from Windsor to the west through Toronto to the east, and therefore we deal with the Toronto and London bankruptcy courts, and what were formerly known as the London, Hamilton, and Toronto Divisional Offices of the Office of the Superintendent of Bankruptcy ("OSB").

(The OSB has re-organized based on function instead of geography, so trustees in Ontario will now deal regularly with OSB representatives from offices in London, Hamilton, Toronto and Ottawa. However, as recently as January, 2007 we can report instances where one divisional office's interpretation of the rules differs significantly from other

divisional offices interpretation of those same rules, so the consistent application of the rules remains an issue for the trustee community).

In our experience, each of the Courts and Divisional Offices apply the Surplus Income Standards differently. While it is not the purpose of this document to question the operation of the Courts or the Divisional offices, we have observed significant variations in the application of the surplus income rules.

For example, we have seen bankrupts with thousands of dollars in surplus income receive automatic discharges after nine months. We have also seen bankrupts with a few hundred dollars in surplus have their bankruptcies extended by many months.

It is theoretically possible for one trustee to apply the rules strictly, extending all bankruptcies for up to an additional twelve months where surplus income exists, and for another trustee to never extend a bankruptcy for surplus income. Depending on the jurisdiction, both trustees may be operating within accepted practices for the area in which they practice.

These anomalies raise the potential of "opinion shopping" by debtors. A debtor with surplus income may actively seek out a trustee that is less likely to extend their bankruptcy, as opposed to finding a trustee that believes in a more strict interpretation of the rules. This in turn may influence the extent to which trustees will impose an extension on a bankrupt for fear of losing clients to a more lenient competitor.

Clearly this brings the entire bankruptcy process into disrepute. All bankrupts should be treated in a similar manner, regardless of who acts as their trustee.

By requiring any bankrupt that has surplus income to make contributions for a specified period of time the inconsistencies that currently exist will be removed and more importantly, the individual debtors may decide on one of the alternate solutions available to them to resolve their financial difficulties.

Recommendation: The Office of The Superintendent of Bankruptcy should modify Directive 11R to require proof of income during the bankruptcy period, and the required surplus income payment should be made by the bankrupt during the bankruptcy period.

Impact of Proposed Changes

We believe the most likely result of these particular amendments will be an increase in the number of debtors that decide to offer a proposal to their creditors instead of filing bankruptcy, which appears to be the goal behind many of the C-55 and C-12 amendments. We can state this with a great deal of confidence because, to the best of our knowledge, our firm files a higher percentage of proposals relative to bankruptcies than any other firm in Canada.

The reason that we have such a high percentage of proposal filings is that we have always taken the position that if a person has the financial means to repay a portion of their debt they should try to do so.

Currently, the advantages to a debtor for filing a proposal as opposed to filing bankruptcy are not always clear. If a person expects to be discharged from bankruptcy after 9 months and you offer them the alternative of paying for 36, 48 or even 60 months many individuals will simply choose the 9 month option.

By enacting these particular amendments, such as extending a bankruptcy to 21 months for individuals with surplus income, a proposal becomes a much more acceptable alternative. We expect that over time the national percentage of proposal filings will climb significantly once these amendments are adopted.

Once again, we turn to Joe Debtor to illustrate our point. We have prepared a schedule (see Appendix E) that compares the average proposal that our clients file to the payments required by Joe Debtor under the proposed amendments. You will note that Joe makes a higher monthly payment if he files an assignment, but the total amount he repays is greater in the proposal because he makes those payments for an extended period of time.

The advantages to Joe of filing the proposal include a lower monthly payment, reduced "paperwork" during the period of the proposal, no additional "penalties" for overtime, extra pay, bonuses or increases in his wages. Most importantly, Joe will feel better about himself for having repaid a portion of his debt voluntarily as opposed to how he might feel if he filed bankruptcy.

The advantage to Joe's creditors is a rate of return that is approximately 2 ½ times greater than the return they would receive if Joe simply filed bankruptcy.

The advantages to the other stakeholders in the insolvency system include reduced administration, reduced Court time, and the subjective benefit of a society in which fewer persons file bankruptcy.

E. Increased debt limit for consumer proposals

We strongly support this amendment.

The proposed amendment is as follows:

> **46. The definition "consumer debtor" in section 66.11 of the Act is replaced by the following:**
>
> **"consumer debtor" means an individual who is bankrupt or insolvent and whose aggregate debts, excluding any debts secured by the individual's principal residence, are not more than $250,000 or any other prescribed amount;**

If we are correct in our belief that the adoption of the previously discussed amendments will result in increased interest in proposals as an attractive alternative to bankruptcy, then the adoption of this amendment may be of critical importance for personal insolvency practices.

In our view, the most significant change for individual consumer debtors contained in Chapter 47 of the Statutes of Canada (formerly Bill C-55) is the proposed increase in the limit on debts an individual debtor may have when filing a consumer proposal.

Under the existing rules a consumer debtor is limited to $75,000 in debt (excluding the mortgage on their principal residence). If they have more than $75,000 in debt and they want to file a proposal, they must file the proposal under Division 1 of the *Bankruptcy & Insolvency Act*.

Appendix F contains a comparison of consumer proposals and Division 1 proposals as set out in the *Act*. Briefly, in our opinion, Division 1 proposals are more costly and less likely to succeed than consumer proposals. If an individual has decided to file a proposal as a means to remedy their financial difficulties, in our opinion, only the Administrator benefits if the individual is required to file their proposal pursuant to the rules for Division 1.

As previously stated, at Hoyes, Michalos & Associates Inc. we are strong proponents of proposals as an alternative to bankruptcy; in fact, in 2008 we expect to file approximately 1,000 consumer proposals, making us one of the highest volume proposal administrators in the country. We believe proposals give people a fresh start, while helping them avoid bankruptcy.

Consider once again, Joe Debtor (Appendix A). Joe, our average debtor, has total unsecured debts of approximately $50,000. Intuitively, if the average is $50,000, a significant portion must have unsecured debts in excess of that number. It doesn't take much to push a person beyond the current $75,000 threshold for consumer proposals.

As an example, an individual recently engaged our services with $100,000 in debts. This person was required to offer their proposal to creditors pursuant to the Division I rules due to the total value of their debt. Only two creditors voted prior to the First Meeting of Creditors; a $10,000 claim in favour and a $1,500 claim against. The proposal was defeated as it did not meet the criteria to be approved for a Division I proposal (it would have passed as a consumer proposal) and now that person is bankrupt.

In 2007 our firm filed 42 proposals under Division 1 of the *Bankruptcy & Insolvency Act* for individuals. If the proposed increase in the unsecured debt limit allowed in a consumer proposal had been in effect in 2007, all but one of these proposals would have been filed as a consumer proposal. That would represent a decrease of 98% in the number of Division 1 Proposals filed by our firm, which represents a 98% reduction in Court time, as well as a significant reduction in OSB administration and trustee fees.

The end result of those savings means more of the debtor's payments are flowing through to their unsecured creditors. Based on our own experience we predict a savings of $5,000 in professional fees per file. If those savings are extrapolated over the total number of Division I filings per year the result could be millions of dollars in additional recoveries by the creditors from reduced professional fees, and a reduction in the number of bankruptcies caused by rejected Division 1 Proposals.

It may seem strange that we are arguing for what will result in a reduction in professional fees. While professional fees may be reduced, we believe this change is in the best

interests of both the debtors and the creditors, and therefore we are strong supporters of this proposed amendment.

We strongly support the adoption of the amendment to increase the debt limit for filing Consumer Proposals to $250,000.

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 clients 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 [13]

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: (more details can be found in Appendix D):

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 [14]
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: Student Loans and Bankruptcy: Additional Commentary

With any other type of debt an individual may consider a proposal to repay a portion of their debts or an assignment in bankruptcy. Why are student loans treated differently?

We acknowledge that student loans are unique. For many people, student loans are the first type of credit an individual receives. As such, the borrower may lack the educational and life experience to determine if obtaining the student loan is a wise financial decision.

Student loans are obtained in anticipation of completing an educational program that will allow the student to secure future employment, and to earn sufficient income to repay the student loan. Unfortunately, not all students complete their education, and the ones who do may not be able to secure employment and earn sufficient income upon graduation to allow them to repay the debt they have incurred.

Some will argue that student loans are treated differently in a bankruptcy than other debts because they feel that a student has the benefit of their education for a lifetime, and therefore it is perceived to be unjust to allow a student to retain the benefit of their education, but not the obligation of the student loan, in the event of a bankruptcy.

We question the validity of this premise.

Consider if you will, an individual that opens a new business, financed in part by government guaranteed small business loans. The person rents space, pays utilities, buys inventory and equipment, develops a product or service and tries to build a business. For whatever reason, the business fails. The individual is responsible for a number of government obligations including their personal guarantees. The person decides to file for bankruptcy and all of these debts are discharged.

A year later and wiser for the experience, the person opens a new business, based in part upon the products and services and experience they developed in their first business, and over time that business becomes a success. No one suggests that the bankruptcy be revisited and the debts repaid.

Compare that to a student loan – an individual commits to a program of education and training with the goal of bettering themselves and obtaining employment at the end of their course of studies. The student loan system allows the person two years of interest relief in order to find employment and establish themselves. At the end of the two years, sooner if they have the means, repayment commences.

But what happens if they haven't found employment? What happens if they are working, but at a wage too low to repay the debt? What if they didn't complete their studies? What if for personal or family reasons they just can't repay the debt?

The small business person that tried and failed was given relief – is it just to require the student to wait 10, or even 7 years to apply for the same relief?

Based on a review of the debtors we have assisted, we note that insolvent debtors with student loans are most likely single, female, and have a dependent. They went to school in order to provide a better life for themselves and their families. Based on our analysis Jane would have been better off to apply for a Small Business Loan and open her own business than try to better herself through education and training…

We understand that the issue of the dischargeability of student debt has been under discussion for a considerable length of time (having been the subject of two previous amendments to the Act in the past 13 years). The insolvency system needs to find the correct balance between the on-going value of a person's education and the relief required when that education does not create the economic means to repay the debt incurred to obtain it.

Prior to 1997, student loans were treated in the same manner as other unsecured debt: they were simply discharged when an individual filed an assignment in bankruptcy. In September 1997 the *Bankruptcy & Insolvency Act* was amended so that student loans were only discharged in a bankruptcy if the bankrupt had been "out of school" for more than two years.

In 1998 the rules were changed again, increasing the time period from two years to ten years. To the best of our recollection, the 1998 amendment was made without extensive consultation with the stakeholders of the insolvency system when it was implemented.

We agree that the pre-1997 treatment of student debt by the *Act* failed to recognize the unique nature of the debt, but respectfully submit that the current limit of 10 years has proven to be too onerous for many individuals.

We believe there is consensus among most insolvency stakeholders that a reduction in the period of exclusion is required. We question the practicality of the proposed reduction to seven years because two other amendments in Bill C-55 conflict with the proposed change.

The first of these amendments is as follows:

> **(3) Subsection 178(1.1) of the Act is replaced by the following:**
>
> **(1.1) At any time after <u>five</u> years after a bankrupt who has a debt referred to in paragraph (1)(*g*) ceases to be a full- or part-time student, as the case may be, under the applicable Act or enactment, the court may, on application, order that subsection (1) does not apply to the debt if the court is satisfied that**
>
> **(*a*) the bankrupt has acted in good faith in connection with the bankrupt's liabilities under the <u>debt</u>; and**
>
> **(b) the bankrupt has and will continue to experience financial difficulty to such an extend that the bankrupt will be unable to pay the debt.**

The adoption of this amendment means that a person may apply to the Court for relief from their student debt after **five** years. The addition of this clause may make the

previous amendment meaningless as we anticipate that most debtors will exercise their right to apply to the Court after five years if the student debt was a contributing factor to their financial distress.

We believe the adoption of this amendment will increase Court time and costs in an unnecessary manner. Amendment 107 is the only one required, if the time restriction is set at an appropriate length of time. Our recommendation is two years.

To further complicate things, there is a third amendment which impacts on student loans that reads as follows:

> **62(2.1) A proposal accepted by the creditors and approved by the court does not release the insolvent person from any particular debt or liability referred to in subsection 178(1) unless the proposal explicitly provides for the compromise of that debt or liability and the creditor in relation to that debt or liability has assented to the proposal.**

This amendment relates specifically to proposals to creditors referred to as Division I Proposals. A fourth amendment later in the document (number 51) proposes a similar amendment regarding consumer proposals.

If these amendments are adopted, the inclusion of either of the two previously discussed amendments may be moot. The seven or five year limitations may be explicitly waived if the creditor related to the debt consents. If the amendments to subsection 62(2.1) and subsection 66.28(2.1) are adopted we believe the required clause to affect the discharge of any student debt would become a standard clause in all proposals, presumably rendering the previously discussed amendments less relevant.

Given the choice, we believe the most practical approach to the problem of the discharge-ability of student debt would be to reduce the time period for the exclusion of student debt to two years (instead of seven) and discard the other amendments. This solution is most consistent with the goal of reducing Court involvement, streamlining the administration of estates, and would provide a universal standard that is easily understood.

We recognize that none of the changes as passed in Bill C-55 will solve the problem of mounting student debt, but we are confident that by reducing the period of ineligibility for discharge from the current ten years to two the Committee will at least allow those persons that are unable to generate sufficient economic benefit from their educations, with relief from what is often an onerous financial obligation.

Appendix E: 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[15]. 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	$2,237	
Surplus income	$367	
Payment required for family	$184	(50% of the total)
Joe's surplus payment	$145	(79% of the total)

In this example, Joe would be required to pay $145 per month for each month that he is 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 $305 per month.

Table 12: Comparison of proposal to bankruptcy

Scenario	Joe's Payments	Dividend to Creditors
Nine month bankruptcy	$2,745	1.3%
21 month bankruptcy	$6,405	6%
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 1.3% dividend on $51,106 in unsecured debts means the creditors have received a repayment of $664.

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 $305 per month for a total of $6,405.

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 F: A Comparison of Consumer Proposal and Division I Proposals to Creditors

Division 1 proposals are more cumbersome than consumer proposals, for the following reasons:

- Under Division 1 rules the creditors only have 21 days to vote, which is a much shorter time frame than the 45 days allowed in a consumer proposal. It is difficult for creditors to process their vote in that time frame, and as a result some proposals are defeated simply because sufficient creditors did not have time to submit their vote in favour of the proposal;
- If a consumer proposal is rejected by the creditors, the debtor may still attempt to make payment arrangements with their creditors; they are not required to go bankrupt. If a Division 1 proposal is rejected, the debtor is automatically deemed to have file an assignment in bankruptcy;
- The costs to administer a Division 1 proposal are higher, for the following reasons:
    - A creditors' meeting is required (in a consumer proposal it is only required if over 25% of the dollar value of the creditors vote against the proposal);
    - The administrator must attend a court approval hearing.
    - A separate trust account must be maintained for each Division 1 proposal (administrators of consumer proposals may maintain one consolidated trust account); maintaining numerous separate trust accounts significantly increases the costs of administration.
    - The administrator must attend at court to have the final financial statement for the proposal approved (taxed) by the court; and
    - The administrator must apply to the court to have the file closed.
- Because the costs to administer a Division 1 proposal are higher than the costs to administer a consumer proposal, the administrator charges higher fees, leaving less available for distribution to the creditors; and
- This lower distribution makes it less likely that creditors will accept a Division 1 proposal than a consumer proposal, all else being equal.

Therefore, where possible, a consumer proposal is in most cases a better alternative for all stakeholders than a proposal filed under Division 1.

Appendix G: Comments on Bill C-55 (Statutes Chapter 47), November, 2005

The purpose of this portion of our submission is to draw the Committee's attention to specific concerns that we have regarding Bill C-55 passed in November, 2005. In most cases we are not offering an opinion on the merit of the amendment; rather we are simply bringing the item forward for discussion. We appreciate that this Bill has been given Royal Assent, and therefore we make these comments with a view to further amendments in the future.

Amendment 1: Wage Earner Protection Program Act (hereinafter referred to as WEPP):

Clause 7 sets out the amount that may be claimed by an individual from the Minister in the event of a bankruptcy or receivership of their employer. The payment is limited to the greater of $3,000 or four times the weekly maximum payable under the employment Insurance Act.

Clause 36 gives the Minister the right to advance a claim in the bankruptcy or receivership for the amount of the benefit paid to each individual pursuant to clause 7.

Amendment 67 of Bill C-55 creates new subsection 81.3 to 81.6, creating a "secured" claim of up to $2,000 for the same benefits provided pursuant to Clause 7 of the WEPP. Security ranks in priority to all other claims except for claims for unsold goods delivered in the 30 days prior to filing, certain agricultural products and trust claims for un-remitted Source deductions.

Concerns:

- Why wouldn't the dollar amounts be identical in each *Act*? (Either $2,000 or $3,000 in both);
- Administratively, the Crown has allowed for the payment of reasonable fees to the trustee pursuant to clause 22 of the WEPP, but the clause does not indicate if these fees rank in priority to the claims or if the Minister is undertaking to pay those fees in the event of a shortfall. Similarly, the addition of subsection 81.3 to 81.6 of the BIA suggests these claims would rank in priority to all other claims, including professional fees. This may make many trustees reluctant to perform the required services;
- Assuming there are insufficient funds in the estate the Crown will be funding the claims under WEPP from general revenues;
- Explicit time limits for the filing of claims pursuant to WEPP should be established. Current provisions require a trustee to notify the Minister when the trustee will be discharged – the ac of discharging a trustee protects the trustee from any liabilities arising from the administration of the bankrupt estate; and

- Some thought should be given to how the creation of the WEPP will impact small and medium sized enterprises seeking credit facilities. The proposed amendments to the BIA may cause a lenders to seriously restrict credit – this may have the adverse affect of limiting new job creation and growth

Amendment 2(5): Subsection 2 of the BIA - Definition of Director:

Concern: the definition as written will require the Court to establish criteria upon which to make a determination whether or not a person is, or is not, acting in the capacity of a director.

Amendment 5(4): Subsection 4 – Related parties:

Concern: the definition as written will require the Court to establish criteria upon which to make a determination whether or not persons are dealing at arms' length.

Amendment 12: Subsection 13.4(1) – Trustees acting for secured creditors:

Concern: this clause may prove impractical in summary administration bankruptcies and consumer proposals. The clause restricts trustees from assisting secured creditors without first obtaining an independent legal opinion when in many cases regarding the validity of the creditor's security position. There are many instances when it is in the estates' best interest to assist with the realization of a secured asset – this clause creates an unnecessary cost to the estate to the detriment of the unsecured creditors.

Amendment 19: Subsection 21 of the BIA – Trustee's duties:

Concern: the amendment effectively repeals the existing subsection 21 and replaces it with something completely unrelated.

Amendment 23: Subsection 30 – On Inspectors:

Concern: this amendment removes any incentive a trustee may have to seek inspectors for a bankrupt estate. In the past, inspectors have authorized trustees to act. This amendment allows a trustee to act in the absence of inspectors thereby rendering inspectors redundant. Historically, inspectors have served as a safety valve to ensure that trustees act in a responsible manner.

Amendment 34(1): Subsection 50(2) – Commencing proceedings under the BIA:

Concern: the amendment states that a proposal is commenced by filing documents with a trustee (as opposed to the Official Receiver). It falls to the trustee to establish the exact time a procedure is considered to have commenced – this may have implications regarding the priority of claims and security in an estate.

Amendment 34(2): Subsection 50(6)(a) – Cash flow formats:

Concern: The amendment requires all cash flow statements submitted in support of Division I proposals to creditors to be broken down into weekly increments. No format is currently prescribed and therefore the information is presented in the manner most appropriate to the debtor's revenue and expense cycles (weekly, monthly, quarterly).

Recommendation: We are of the view that cash flow forecasts should be prepared based on time periods relevant to the debtor's actual cash flows, but in no case should the cash flows contain projections for increments of longer than one month.

Amendment 52: Subsection 66.31(6) Automatic re-instatement of a consumer proposal

Concern: the Act currently deems a consumer proposal to be annulled automatically once it becomes the equivalent of three (monthly) payments in arrears. The proposed amendment provides a mechanism for the automatic resurrection of an annulled proposal in 45 days unless a creditor objects, at the discretion of the Administrator. In the past 5 years we have filed more than 2,000 consumer proposals and we have only asked the Court to resurrect two annulled files. We believe subparagraphs 6, 7 and 8 could be deleted from the amendment. We are concerned that if the clauses stand, there is potential for abuse of the system to the detriment of the creditors' rights.

Amendment 56: Subsection 66.38 – Counselling

Concern: Subparagraph 2 effectively makes counseling mandatory in consumer proposals. Currently, if counseling is not performed there are no consequences for the debtor.

Recommendation: We support this amendment.

Amendment 57(1): Subsection 67(1)(b) and (b.1) - RRSP exemption

Concern: the amendment includes an exclusion for funds deposited into an RRSP in the 12 months immediately preceding an assignment. When this matter was discussed with/by the trustee community, the suggested period for exclusion was three years (that is money deposited within the three years immediately preceding an assignment would not be exempt from seizure). A one year period leaves this process open to abuse and manipulation by debtors who wait one year to file; a three year period is more difficult to manipulate.

Recommendation: We believe only funds deposited into an RRSP in the three years preceding an assignment should be exempt from seizure.

Amendment 57(2): Subsection 67(1)(c) – Post bankruptcy tax refunds

Concern: the Courts have ruled in the past that post-bankruptcy tax refunds are not to be considered property of the bankrupt and therefore may be voluntarily assigned, but not automatically seized by a trustee. The dollars involved are not material to the creditors, but represent a significant benefit to the individuals that have filed bankruptcy. We suspect the majority of these dollars will be retained by trustees as fees for bankrupts that do not otherwise have the ability to pay for their services.

Recommendation: We believe that post-bankruptcy tax refunds should remain the property of the bankrupt, and therefore we do not support any amendments in this area.

Amendment 58(1): Subsection 68 (1) to (7) – Surplus Income

Concern: Subparagraph (3) of the amendment seems to limit the trustee's obligation to determine surplus at the date of the assignment, when the trustee becomes aware of a material change in circumstances of the bankrupt, and at the preparation of the report of the application for discharge (commonly known as the Section 170 report). Currently there is a great deal of discrepancy in the application of the rules regarding Surplus Income.

Recommendation: We submit that a more useful (and by that we mean "less subject to interpretation and abuse") amendment would be that "the trustee is required to review and determine the surplus obligation owed by the bankrupt monthly based on the reports the bankrupt is required to submit to the estate." Language of this sort is unambiguous and would lead to a more consistent application of the standard. It would also make the filing of a consumer proposal more attractive to individual debtors as there is no such monthly reporting requirement in a proposal. We have included detailed comments on this section in the body of our report.

Concern: Subparagraph (4) sets out a requirement to notify the official receiver and creditors whenever the trustee has determined an obligation to pay surplus exists.

Recommendation: Again, if the above noted suggestion is followed, a summary of a bankrupt's surplus obligation month by month could be added to the Section 170 report. In our opinion, this would be a more efficient and effective method to communicate this information to the official receiver and creditors.

Amendment 58(2): Subsection 68(10) – Application to the Court to garnishee wages

Concern: Subsection (10) appears to provide the trustee with the option of applying to the Court to fix a bankrupt's payment (for surplus income) if the bankrupt fails to comply with the requirement to pay pursuant to the Act. The purpose of this amendment appears to be to streamline the collection process, perhaps eliminating the need for mediation as it currently exists in the Act.

Recommendation: A more efficient approach might be for the trustee to serve notice on the bankrupt and the official receiver of the trustee's intent to garnishee and if no objection is received the trustee has the power to do so without the requirement to have the Court fix the amount or order the payment.

Amendment 58(4): Subsection 68(15) – Limiting the period that surplus is calculated

Concern: earlier amendments require the automatic extension of the period a debtor remains bankrupt if they have an obligation to pay surplus income. The effect of this amendment seems to limit the application of surplus obligations if the discharge of the bankrupt has been opposed. This amendment is contrary to the amendments that impose an automatic extension of the bankruptcy if an individual is required to pay surplus income. If this amendment is adopted, a person required to pay surplus could deliberately fail to perform one of their other duties which would result in an opposition to their discharge, thereby terminating the obligation to pay surplus.

Amendment 62(1): Subsection 69.3(1.1) – termination of the stay of proceedings

Concern: current law was deemed ambiguous once the Court ruled in MacDonald that the trustee's discharge does not necessarily cause the stay of proceedings to be lifted against a bankrupt. This amendment clarifies the law and removes any ambiguity.

Recommendation: We support this amendment.

Amendment 68: Subsection 84.2 – Prohibition against contract termination

Concern: recently a major Canadian bank has begun terminating any financing agreements with its clients that file bankruptcy. This has created a great deal of additional hardship on families that are already under significant stress. This amendment now prohibits anyone from terminating a contract with a person simply because they have filed an assignment.

Recommendation: We support this amendment. This is a very good amendment as it is an example of the "balance" between debtors and creditors of which we have spoken in other parts of our submission.

Amendment 83: Subsection 116(1) – Appointment of Inspectors

Concern: consistent with Amendment 23, this technical update provides for the creditors to agree that no inspectors will be appointed. Given the use of the term "shall" it appears the creditors must either appoint or agree not to appoint, as opposed to simply not appointing.

Amendment 95: Subsection 156.1 – Extended period to pay trustee fees

Concern: Currently trustees may not collect any payment from a bankrupt after the bankrupt's date of Automatic Discharge if such a discharge was granted. This amendment allows a person that had no surplus income during the initial 9 months of their bankruptcy to take up to an additional 12 months to pay the trustee's fees even if they have received an Automatic Discharge. The purpose of this amendment appears to be to reduce the number of bankruptcies that are opposed simply because the trustee has not been paid. Respectfully, if a trustee has not been paid they will not be inclined to grant someone an Automatic Discharge because if the person fails to meet the terms of extended repayment the trustee would be required to ask the Court to annul the Automatic Discharge and then hear an application for Discharge. The amendment may have the net effect of increasing Court involvement contrary to its intended purpose.

Amendment 100: Subsections 168.1, 168.2 – Extending the duration of a bankruptcy due to surplus income

See our comments in the main body of this report.

Amendment 105: Subsection 172.1 – Discharge for Bankrupts with large tax debts

Concern: this amendment will impact significantly less than 1% of all persons filing bankruptcy. It requires a hearing to be held in order for the bankrupt to obtain an Order of Discharge. As a creditor, the Canada Revenue Agency ("CRA") has always had the right to oppose any bankrupt's discharge, thereby requiring a hearing to be held in order for the bankrupt to obtain their discharge.

If the purpose of this amendment is to act as a deterrent to bankrupts then the threshold must be lowered dramatically. If the purpose of this amendment is to relieve CRA from opposing for unpaid income taxes then again, the threshold must be dramatically lowered to be useful.

If the purpose is to slowly pick away at the various items that are dischargeable by filing bankruptcy then presumably the amendment may remain unchanged. From a

practical standpoint it won't be utilized more than once or twice a year in our own practice.

Recommendation: We do not support this amendment.

Amendment 111: Subsection 199(b) – Obtaining credit without disclosing bankruptcy

Concern: the current threshold requiring a bankrupt to advise anyone extending them credit that they are in fact bankrupt is $500. The amendment will increase that threshold to $1,000. We believe the threshold should be lowered, not raised. In recent years we have seem an alarming increase in the number of payday loan businesses and pawn shops. If the limit is raised to $1,000, the majority of the transactions that occur with these businesses would not require the bankrupt to disclose their bankruptcy. This in turn may allow a bankrupt access to the worst kind of credit after they file.

Recommendation: We do not support this amendment; we believe a $100 threshold is more appropriate.

Endnotes

[1] 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).

[2] 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] Source: Statistics Canada: http://www.statcan.ca/Daily/English/071018/d071018b.htm

[4] Source: Statistics Canada: http://www.statcan.ca/Daily/English/071018/d071018b.htm

[5] Source: *Report on Student Debt: Canadian College Student Survey and Canadian Undergraduate Survey Consortium*, published in 2007 by The Canadian Millennium Scholarship Foundation, ISSN 1704-8435, page 5

[6] Source: *Report on Student Debt: Canadian College Student Survey and Canadian Undergraduate Survey Consortium*, published in 2007 by The Canadian Millennium Scholarship Foundation, ISSN 1704-8435, page 17

[7] Source: *Report on Student Debt: Canadian College Student Survey and Canadian Undergraduate Survey Consortium*, published in 2007 by The Canadian Millennium Scholarship Foundation, ISSN 1704-8435, page 5

[8] Source: Statistics Canada survey *The Wealth of Canadians: An Overview of the Results of the Survey of Financial Security 2005*

[9] Source: Statistics Canada survey *The Wealth of Canadians: An Overview of the Results of the Survey of Financial Security 2005*

[10] 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)..

[11] Surplus Income, simply defined, is the bankrupt's excess income over the limits set out in the Rules and Directives. As a simple example, a single bankrupt with no dependants and no unusual expenses is permitted to earn $1,797 in take home pay each month. All income over this limit is defined as "surplus income", and the bankrupt is required to contribute to their estate each month 50% of their income in excess of this limit (and 75% of all income in excess of $1,000 over the limit). Thus a single bankrupt with $1,997 in take home pay is $200 over the limit, and would contribute $100 during each month of the bankruptcy.

[12] Source: Directive 11R, http://strategis.ic.gc.ca/epic/site/bsf-osb.nsf/en/br01055e.html

[13] 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)

[14] 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)

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