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# HOYES • MICHALOS

& ASSOCIATES INC. – TRUSTEES IN BANKRUPTCY

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## **Special Report**

# **100,000+ Consumer Insolvencies In 2005: Many Canadians Teetering On The Brink Of Financial Distress**

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## *1. Executive Summary*

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In 2005, the number of Canadians that filed personal bankruptcy (or a proposal to their creditors) topped the 100,000 mark – the first time that this has happened in our country. Statistically, 4 out of every 1,000 adults declared themselves to be insolvent and we see this trend continuing to rise for obvious reasons:

- Consumers are carrying too much debt. The average Canadian now owes 18% more than they will earn in 2006.
- Low interest rates, increasing property values and a stable labour market have helped consumers make their monthly interest and debt payments.
- For the debtor on the brink however, recent trends are increasing their financial vulnerability. Debtors on the brink are more likely to use high cost alternative credit including financing company loans, payday loans and credit cards.
- A recent study conducted by our firm showed that payday loans used by bankrupts more than doubled from 2003 to 2005. The same study showed debtors on the brink are more heavily indebted to credit card companies with an average debt per card of \$9,625 compared to \$2,329 for the average consumer. And total average credit card debt per bankrupt was a staggering \$35,960.
- Although the labour market in Canada has been strong for a sustained period of time, consumers with excess debt levels are more at risk to job loss. Today more than 65% of couples are in two-income families, compared to 59% in the mid 1990's.
- Personal savings as a percentage of disposable income has fallen dramatically in recent years and is in fact projected to become negative in 2005. Less savings means less cushion in the event of a job loss or other personal catastrophe.

Overall, we see an increased risk to the consumer on the brink of financial disaster. As a result we are predicting an increase in the number of consumer bankruptcies and proposals in the range of 3% to 5% over the next two years.

## ***2. Canadians are Carrying Too Much Personal Debt***

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The trend continues: consumers are carrying more debt. Household debt per adult increased more than 8% in 2004 and 9% in the first 10 months of 2005.

The rate of increase in personal debt surpassed growth in disposable income – again. The debt-to-income ratio increased to a record 118.3% in the third quarter of 2005.

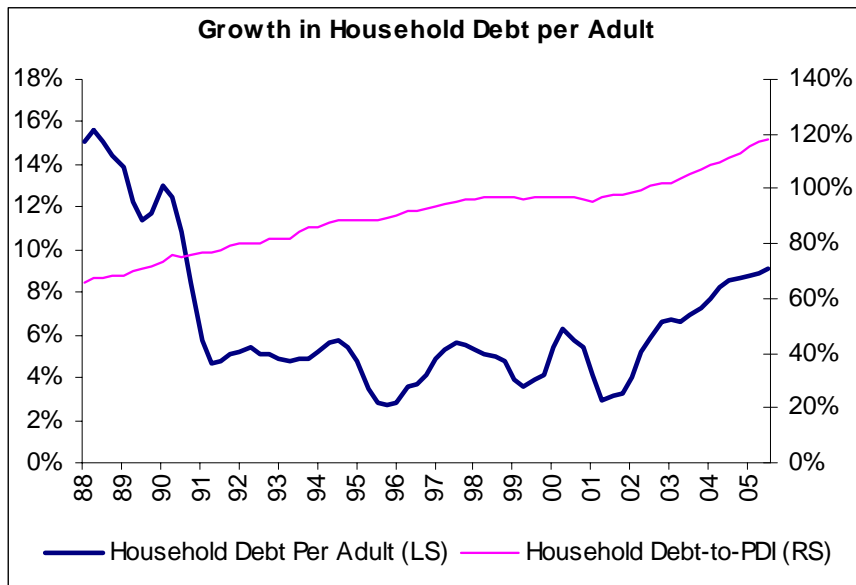
In layman's terms, that means that the average Canadian now owes 18% more than they will earn in 2006.

There are many reasons why the trend toward higher debt levels are, as yet, not resulting in a dramatic increase in the number of consumer bankruptcies:

- Interest rates have remained relatively low;

Household net worth is increasing, driven largely by higher home valuations;

- Consumers are offered a wider variety of low-interest debt alternatives than ever before; and
- The labour market has been relatively healthy for an extended period of time.



Source: Statistics Canada

### 3. Many Canadians Teetering On The Brink

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To some, this may not sound like a problem. As long as interest rates remain low, most people can afford to make their monthly payments. Although this may sound reasonable, for the “average consumer” a high debt-to-income ratio means they are less able to deal with life’s unexpected financial traumas. These include a marital breakdown, job loss, illness and others. In short, Canadian families are becoming more financially vulnerable.

Debtors with low incomes or poor credit are not eligible for low cost loan alternatives such as Personal Lines of Credit. They are increasingly relying on alternative credit including financing companies, payday loans and credit cards. In addition, those heavily burdened with debt are most vulnerable to job loss.

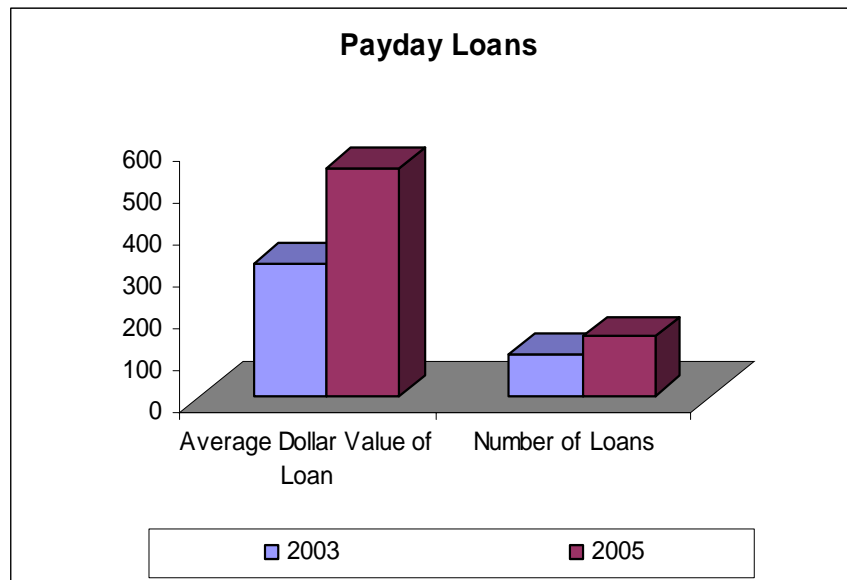
#### Payday loans

The use of payday loans is on the rise. Money Mart, the largest payday loan company in Canada opened in 1983 with 16 outlets. The company now reports it has over 350 outlets in Canada.

A study commissioned by Hoyes, Michalos & Associates Inc. showed the average number of payday loans reported by bankrupts more than doubled from 2003 to 2005 and the average size of payday loans increased 1.71 times over the same period.

According to the Money Mart website “The typical Money Mart customer accurately represents the average, working Canadian. Statistically, the average customer is 32 years of age and employed with an annual income at the national average – 82% of all customers are under the age of 45.”

Clearly, the average working Canadian is increasingly relying on payday loans to meet their weekly financial obligations.

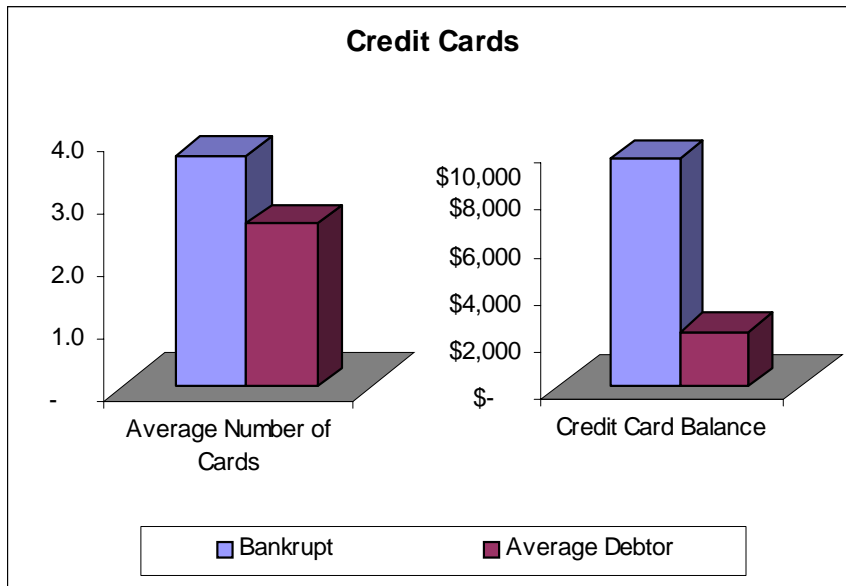


Source: Hoyes, Michalos & Associates Inc.

### Higher Use Of Credit Card Debt

Our recent study also showed that, on average, bankrupt clients had 4 credit cards with balances and they were carrying total credit card debt of \$35,960. This equates to an average of \$9,625 per card compared to an overall average of \$2,329 according to the Canadian Bankers Association.

Consumers with poor credit or who have little or no assets to secure low rate loans are relying more heavily on credit card debt than the average householder.



Source: Hoyes, Michalos & Associates Inc., Canadian Bankers Association

### Stressed Families At Risk From Job Loss

Those on the brink are also more likely to be vulnerable to even modest increases in the unemployment rate. Our study of the average bankrupt showed that 33% of clients stated that lay-off or reduced income contributed to their financial problems. Statistics Canada reports that for almost 65% of all couples, both partners worked. This compares to 59% in the mid-1990's. Average total family income for dual-earner families was \$89,600 in 2003. This compared to \$68,700 where only the husband worked and \$55,900 where only the wife worked.

For those families on the brink, a job loss by even one spouse can be enough to make interest and debt payments unmanageable.

## Little Cushion Left

Average household savings has steadily declined. Personal savings as a percentage of personal disposable income was only 1.4% in 2004, compared to 9.5% in 1994 and 16.7% in 1984. In fact, personal savings is projected to decline in 2005.

Less savings means less cushion for meeting monthly financial obligations in the event of job loss or other personal catastrophe.



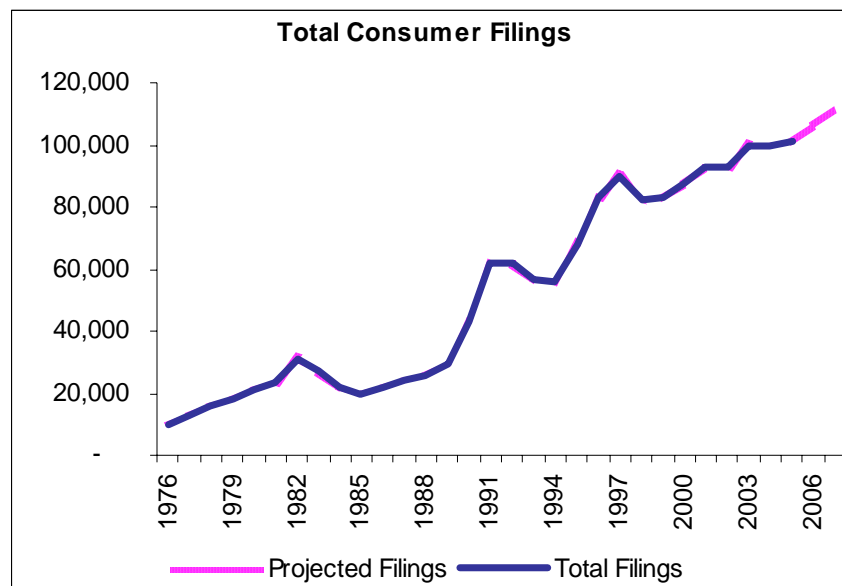
Source: Statistics Canada

## 4. This Will Eventually Translate Into Higher Consumer Filings

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Although the vast majority of Canadians have been able to handle ever increasing debt levels, for those on the brink the burden is becoming overwhelming. Strong growth in employment and low rates have helped keep the growth in consumer bankruptcies and proposals relatively low in recent years however we feel that even moderate increases in interest rates or unemployment will change this.

**Overall Hoyes, Michalos & Associates predicts an increase in the number of consumer bankruptcies and proposals in the range of 3 to 5% over the next two years. Every 1% increase equates to another 1,000 Canadians facing financial distress.**



Source: Statistics Canada, Hoyes Michalos & Associates