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Canada

Message from the Superintendent 1

Funding Options — a Response to *Meeting the Challenge* 5

Index of Directives Currently in Effect 19

Changes to the Involvency System Concerning Student Loans 23

Making Peace on the Bankruptcy Battlefield 31

Changing Trends in Canadian Bankrupt Demographics: Comparison of 1982 and 1994 National Studies 37

Addresses of Offices of the Superintendent of Bankruptcy A-1

Change of Address Form A-2

4 1998
1-2 1999

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INSOLVENCY BULLETIN

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The objective of the Insolvency Bulletin is to promote communication and strengthen ties between the Office of the Superintendent of Bankruptcy and insolvency professionals. The Insolvency Bulletin is a free publication which is published four times a year. The Bulletin is aimed particularly at trustees, jurists, registrars, accountants, credit managers and to those with a general interest in bankruptcy and insolvency.

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Message from the Superintendent

It has been a very busy and productive time at the Office of the Superintendent of Bankruptcy and I wish to take this opportunity to keep our readers abreast of the most recent and exciting changes which have taken place over the past few months.

On May 7th, a Management Advisory Board (MAB) meeting was held in Ottawa to discuss a host of issues. Most notably, the Board endorsed the OSB's actions taken as part of our transition to a special operating agency (SOA) and a new revenue generating fee structure was presented for its review and comments. In addition, new performance indicators gauging the overall effectiveness of the OSB's stakeholder services were introduced.

OSB FUNDING

You may have noticed that in the last issue of the *Insolvency Bulletin* (2nd & 3rd Quarter, 1998) we featured a Funding Options discussion paper. At that time we invited members of the insolvency community to submit their comments on the proposed methods of funding the OSB's operations. The response to the discussion paper was excellent, both in terms of quantity and quality, and your comments have provided us with much-valued guidance on how to best approach full cost recovery for our programs and operations.

A key element of our strategy to achieve full cost recovery will be a continued initiative to increase our efficiencies. An important part of our approach will consist of achieving $2 million of savings as a result of moving our transaction based activities to e-commerce. While it would be premature to introduce two-tier fees to support electronic services at this time, we are seeking the view of stakeholders on our approach in this area.

We have now completed a review of the comments and briefs submitted by individuals and various associations and have developed a set of proposed fee changes that were submitted to the MAB during our May 7th meeting for feedback and guidance. Based on the comments received, we have prepared our proposals for a new fee structure and have featured them in this issue of the *Insolvency Bulletin* and on our web site (osb-bsf.ic.gc.ca) for review and comments from stakeholders.

UPDATE ON SERVICE PROVIDER INITIATIVE

With respect to the OSB's Service Provider Initiative (SPI), we have started the negotiation process for the specific provision of services, which we hope to have concluded before the end of the year.

The goal of the SPI will be to connect the insolvency community through an electronic network that will include the courts, trustees, the OSB and the creditors. This will allow all parties involved to increase their efficiency in handling insolvency estates, while allowing the OSB to focus on its core responsibilities and duties as a marketplace regulator. This initiative is also playing an important role in the OSB's transformation to a special operating agency and its related goal of full cost recovery of its programs and operations.

The OSB will be involving the trustee community through a joint committee comprised of representatives from the Canadian Insolvency Practitioners' Association (CIPA) and the OSB. The primary purpose of this committee is to act as an advisory body to the Superintendent and the Executive of CIPA. The Committee will play a key role in communication and consultation with the trustee community and will contribute to the plans for rolling out new electronic services involving trustees with regard to the timing, cost benefit analysis, technology and training requirements.

One of the central challenges of this project will be for the trustee community and the OSB to collaborate to ensure that a comprehensive electronic framework is put into place that will be workable and user friendly, to the benefit of all stakeholders in the insolvency process.

THE NATIONAL INSOLVENCY FORUM

In late spring, the OSB embarked on a new form of stakeholder consultations. Due to the constantly changing nature of economic activity in Canada and throughout the world, it has become imperative that Canada maintain a strong, efficient and equitable insolvency system in the next millennium. As well, the OSB approaches the 21st century with the continuing challenge of how to best ensure compliance with the *Bankruptcy and Insolvency Act* (BIA) — an activity that is both crucial to protecting the integrity of the system and important to clients and stakeholders alike.

Recognizing these principles and the fact that an effective insolvency system contributes to the overall competitiveness and stability of the Canadian economy, the OSB established the National Insolvency Forum (NIF). The NIF consisted of a series of six two-day conferences which were held in Halifax, Montreal, Toronto, Saskatoon, Calgary and Vancouver during the month of May. Our goal was to bring together Canada's insolvency stakeholders and representatives to provide a "report card" on the state of Canada's insolvency system.

The NIF approach focused on the operational aspects of the insolvency process, which was examined in relation to each stakeholder's interests and goals in each region of the country. Participants were asked to explore solutions that will streamline the insolvency process and make it more efficient and effective.

The particular focus of these conferences set them apart from all other previous stakeholder consultations and was very successful in generating a great deal of debate and recommendations for changes and improvement to Canada's insolvency system.

The recommendations from each NIF conference will now be considered by the OSB for implementation by way of voluntary codes of practice or through the issuance of circulars and directives. Recommendations which require amendments to the BIA will be sent to Industry Canada's Corporate Law Policy Directorate for consideration during the next Parliamentary review in 2002. Before the end of the year, a National NIF Report summarizing key points, issues, decisions, and recommendations will be published in the OSB's *Insolvency Bulletin*. This report will also be published on the OSB's web site.

REGULATORY MATTERS

- A joint letter between the OSB and CIPA regarding Trustee Advertising will be issued shortly. The increasing number of complaints received by the OSB and the CIPA regarding the advertising practices of certain members of the trustee community prompted this course of action. We hope that this letter will address the problem and convince some practitioners to change their advertising practices to reflect the high degree of professionalism found throughout the trustee community.

- An OSB working group has recently prepared a review of the OSB's compliance strategies for trustees and debtors. Our goal is to devise a new compliance strategy in the coming months which will improve the manner in which the OSB ensures compliance with the BIA while maintaining a high degree of efficiency and effectiveness.

- We will also be issuing a trustee licensing directive to replace the licensing policy that was released a decade ago. It will also replace certain directives and consolidate them (along with the policy) into a single one that will provide the trustee community with a uniform, national criteria for the issuance and maintenance of trustee licences. In addition, this directive will fortify the Memorandum of Understanding between the OSB and CIPA that established the National Insolvency Qualification Program (NIQP). Essentially, it will inform future applicants for licences of the requirements for becoming a licensed trustee, while clarifying for practising trustees the requirements for maintaining their licences.

- Over the past few months the Joint Committee on Bankruptcy (JCB) has been reviewing Forms 65, 72, 79 and 82 in order to address certain shortcomings expressed by practioners since their issuance on April 30th, 1998. We are now in the final stages of reviewing these forms which were examined by the JCB in late June.

- Many practitioners have sought clarification regarding the approach Official Receivers should take in converting summary estates to ordinary administration. The main issues revolve around the $10,000 threshold for summary administration and the circumstances in which conversion would be warranted when the estate realization ex-

ceeds $10,000. Following discussions with the CIPA executive, and feedback received from practitioners, we have developed an insolvency circular that will provide clarification to practitioners as to what they can expect Official Receivers to look for regarding conversion issues. We are currently finalizing the circular which will be distributed to all trustees in early September.

- On June 24, 1999, the Manitoba Court of Appeal issued its decision in the Berthelette case. The Court ruled that in the particular circumstances of the case, the claim of the trustee pursuant to an agreement with a bankrupt regarding his fees constituted a provable claim which was released by the debtor's discharge. As a result, the trustee was ordered to reimburse to the former bankrupt the payments received after the debtor's discharge. The decision upheld the position of the OSB on this issue. The OSB has agreed to resume discussions with CIPA to develop a policy that would be fair to practitioners, minimize the burden to the Courts in these matters, be equitable to debtors and creditors alike and provide compliance with the BIA and the case law on this issue.

N.B. Until such a policy can be developed and a proper directive issued, it is the position of the OSB that it is not acceptable for a trustee to require payments from a bankrupt following his or her discharge, and any such amount should be returned forthwith to the debtor.

Funding Options — a Response to *Meeting the Challenge*

INTRODUCTION

In the last edition of the *Insolvency Bulletin*, the Office of the Superintendent of Bankruptcy (OSB) published a revenue options discussion paper entitled 'Meeting the Challenge'. The discussion paper outlined the need for full cost recovery, including the measures being taken to reduce costs and improve OSB compliance activities, and invited clients and stakeholders to provide their input on 15 possible funding options.

The purpose of this paper is to provide you with feedback on the comments and briefs which were submitted, to outline the process which was followed by the OSB to analyze these comments, and to present a draft set of funding proposals for your comment and consideration.

THE COMMENTS RECEIVED

The OSB received 34 written briefs and submissions from associations and individuals representing trustees in bankruptcy, creditors, insolvency counsellors, professional associations and other interested parties. While some commented on all the revenue options, others provided suggestions of their own on how to improve the fee structure.

While Annex A provides greater detail on the comments received against each of the revenue options, the following is an overview of the major points which were raised:

- Overall, strong support was received from stakeholders for setting the levy in summary estates (i.e., estates with net assets less than $10,000) at 100% of the first $200 in dividends available to creditors, and 0% afterwards as it: a) is directed only at summary estates, where the largest gap exists between costs and revenues; b) better reflects OSB's costs in providing services; and c) would reduce the administrative costs for creditors and trustees of distributing and handling numerous small dividend cheques.
- In general, creditors also supported using registration fees to reach full cost recovery as they better reflect the true costs of delivering OSB services, while trustees and insolvency counsellors expressed concern over the effect higher fees might have on access to the bankruptcy and insolvency system by low income debtors.
- There was mixed support from the trustee community for increasing the trustee licence fee to levels of other professions as some believe that creditors, debtors and even the public should be responsible for these costs as they ultimately benefit everyone. Other trustees pointed out that due to the limited size of the trustee community (i.e., 875 active trustees), these fee options would make relatively little impact on bridging the existing revenue shortfall.
- Finally, while there was some support for 'reasonable' administrative fees, such as charging for a change in filing status, or for processing claims against trust funds being held by the OSB, many cautioned that the costs associated with collecting a series of small fees may outweigh the benefits.

THE PROCESS FOLLOWED

The OSB established an internal project team in February 1999 to analyze the briefs and submissions received. It began its analysis by reviewing all submissions, identifying suggestions submitted by clients for the new funding options, and seeking legal

advice as to which of the existing and new funding options would require changes to the *Bankruptcy and Insolvency Rules* and which would require amendments to the *Bankruptcy and Insolvency Act*.

The OSB project team then evaluated each of the funding options against the evaluation criteria which were outlined in 'Meeting the Challenge'. To recap, they were:

➢ Equity: those that benefit from a service should pay for it;

➢ Fair share: when the benefits of a service accrue to the entire community, all participants should pay their fair share of the costs;

➢ Simplicity: fees should not be unnecessarily complex;

➢ Public good: fees should support public policy objectives, such as accessibility to the system, debtor rehabilitation and timely return of assets to productive use;

➢ Value: fees should reflect the cost of providing the service;

➢ Flexibility: the fee structure should be flexible enough to permit the OSB to respond to future marketplace and client needs; and

➢ Transparency: the rationale or conceptual basis for the fee should be evident to clients and stakeholders.

To further facilitate its analysis, the project team added two additional user fee guiding principles:

➢ Revenue generation potential: funding solutions must meet the OSB's financial requirements; and

➢ Client and stakeholder acceptability: the funding solution should be acceptable to the majority of clients and stakeholders.

On May 7th, the project team presented its findings and draft recommendations to the Superintendent of Bankruptcy and the OSB Management Advisory Board (consisting of representatives from the private sector and provincial governments across Canada). The Board's discussion centred primarily around how to achieve the best balance between meeting the financial needs of the OSB and its paying clients, while ensuring that public good considerations are safeguarded.

For example, while the Board expressed its concerns over any possible negative impact large registration fee increases might have on system access by low income debtors, they also acknowledged the unreliable nature of the levy as a revenue source for the OSB in future years.

Subsequent to this meeting, further analysis was completed on the impact of various fee scenarios over the coming five years and the number of consumer estates which might be affected by a change in the registration fee.

THE OSB PROPOSAL

In order to achieve the optimum balance between the public good and the need for a strong financial framework for the future, the OSB is proposing a set of seven fee recommendations for client and stakeholder consideration. The OSB also wishes to signal to its clients and stakeholders its intent to revisit this fee structure over the next two to three years should anticipated savings from electronic registration and e-commerce not materialize as planned.

In addition, as Industry Canada is promoting the use of e-commerce as a way of improving services to its clients, the OSB will be examining the possibility of using a two-tier fee structure to encourage stakeholders to use e-commerce.

The fee recommendations, therefore, are as follows:

Registration fees

1. Increase the registration fees for summary administrations from $50 to $75.
2. Increase the registration fees for consumer proposals from $50 to $100.
3. Increase the registration fees for repeated summary administration bankruptcies from $50 to $150.

Levy

4. Increase the Superintendent's levy to 100% of the first $200 of dividends in summary administrations with no further levy on any dividends over $200.

Trustee licence

5. Increase the annual trustee licence fee renewals to $850. This increase will be used to set up a reserve

fund to cover the OSB's costs in conservatory or other disciplinary measures.

Miscellaneous

6. Charge a fee of $75 to change from a summary to an ordinary administration.

7. Charge creditors, or their agents, a $30 fee for each estate claim made against the unclaimed dividends trust fund held by the OSB.

With regard to the above fee package, it is important to note the following:

- 'Meeting the Challenge' identified a gap between OSB costs and revenues of approximately $6.5 million. This gap was calculated over a five-year planning horizon, and took into account file volume fluctuations and increases in salary costs through collective agreements, as well as other cost drivers. It also took into account the cost saving anticipated through the adoption of a private sector service provider to introduce electronic registration of bankruptcy proceedings and e-commerce. The service provider savings were estimated at $2.0 million by 2003-04.

- The service provider initiative is proceeding, and the OSB is currently negotiating a multi-year contractual agreement with a potential service provider. It is expected that the agreement will be in place by ***the end of the year*** and that electronic registration of bankruptcy proceedings will be an immediate priority.

- In the event that savings from electronic registration and e-commerce cannot be harvested (either because there is insufficient uptake by the trustee community, or because services are not available from the service provider in time), then the gap between costs and revenues would increase by up to $2.0 million. In this event, the OSB would have little choice but to return to its fee structure to make further revisions.

- Finally, it is important to highlight that Industry Canada is committed to raising Canada's productivity and positioning Canada for the 21st Century. An important component of this strategy is to make Canada the most connected country in the world. Through this approach, not only will industry prosper, but so too will all Canadians.

THE RATIONALE BEHIND THE PROPOSAL

The OSB believes that using a seven-point fee proposal, rather than one or two large fee increases, will provide a balance between the needs of the clients, stakeholders and the OSB for a self-funding financial structure, and the need to protect the public good.

The proposal takes into account the strong support received from clients and stakeholders for a flat 100% levy on dividends from summary (consumer) administrations up to $200, while limiting the increase in registration fees to a level which should not compromise access to the system by low income debtors. These two increases will generate the bulk of the $6.5 million required to move the OSB toward cost recovery.

Greater detail on each recommendation follows:

Registration fee revenues

Increasing the registration on summary bankruptcies to $75, on consumer (Division II) proposals to $100, and for repeat bankrupts to $150 will generate an estimated $3 million in 2000-01, which is almost half of the $6.5 million required. The rationale for using this approach includes:

- Registration fee revenues are closely tied to workload fluctuations, and provide immediate working capital for the OSB. More specifically, unlike levy revenues, registration fees are paid at the beginning of the bankruptcy process when the bulk of the work takes place.

- The fee increases are aimed primarily at consumer bankruptcies, where the largest gap exists between current revenues and OSB costs.

- As one of the major beneficiaries of the system, debtors will be making a further contribution to financing the cost of the system.

- Restricting the registration fee increase to $25 should not materially restrict debtor access to the bankruptcy system given the significant financial relief that debtors receive from bankruptcy proceedings. The OSB is also confident after reviewing the number of low asset estates filed last year, that all consumers who are in need will be provided

with access to the system through the Bankruptcy Access Program.

- Most creditors, in their submissions, encouraged the OSB to charge their costs up-front and rely less on the levy as a source of financing, as the levy can vary from estate to estate, and is received often two years after the majority of the work has been done.
- The $150 registration fee for repeat bankrupts recognizes the additional work performed by the OSB in examining the debtor and supervising cases of repeated bankruptcies.
- The proposal acknowledges that those filing consumer (Division II) proposals are able to pay a greater portion of the OSB costs associated with their supervision than are most consumer bankrupts.
- Registration fee revenue is a more predictable revenue generator than levy.
- A change to the *Bankruptcy and Insolvency Act* is not required to amend the fee amounts.

Levy revenues

Changing the structure of the levy on summary (consumer) bankruptcies so that it is 100% of the first $200 in dividends, and nothing afterwards, will eventually generate approximately $3 million for the OSB. Again, this proposal acknowledges that it will take two to three years for a change in the levy to be realized, as levy is paid only upon the closing of the bankruptcy.

In the OSB's view, there are four major advantages to changing the approach to levy funding:

- The proposal acknowledges that, while the debtors will be paying approximately $3 million in new registration fees, the creditors must also pay their fair share in bridging the $6.5 million revenue shortfall. This change in levy will generate a comparable $3 million and allow the OSB to limit the increase in registration fees to $25 for consumer bankruptcies.
- The change is directed only at (consumer) summary estates where the largest gap exists between revenues and current OSB costs.
- The new levy was endorsed by most creditors and trustees in their submissions as it would reduce the need for them to administer large numbers of small dividend cheques, and would cap the amount of levy on any one summary estate at $200.
- The proposal addresses creditors' concerns that any further increase to the current 5% levy would turn the levy into another form of taxation.

Trustee licence fee revenues

The OSB is proposing that annual licence renewal fees be increased from $400 to $850 with the incremental revenue going toward a fund to cover trustee discipline actions such as conservatory measures.

The OSB is proposing that the trustee licence fee be increased by $450 for the following reasons:

- Due to the limited number of trustees (i.e., there are currently 875 active trustees) they cannot reasonably be expected to pay the full cost of discipline actions, such as conservatory measures, which can run into millions of dollars each year. However, they should be required to pay professional fees which are comparable to those for other professional associations in Canada.
- The additional revenue (i.e., $450 per year per trustee) will contribute to a special fund to pay for conservatory and disciplinary measures. Should this fund continually generate a reserve above what is required, then the Superintendent would be able to reduce the licence fee in the future.
- It is administratively more efficient to include various licence services (such as for amending or re-issuing licences following mergers, or changes in district or name) in the yearly renewal fee than it is to bill for each service individually.
- This is expected to generate an additional $410,000 per year.

Miscellaneous fees

The OSB is proposing two miscellaneous fees :

a) an additional $75 would be paid when converting a summary administration to an ordinary administration. This would generate approximately $55,000 per year;

b) a new $30 fee will be charged for processing estate claims by creditors and their agents against unclaimed dividends being held in trust. This proposal would generate approximately $60,000 per year.

The rationale for these two proposals is as follows:

- Bankruptcies which begin as summary administrations, but are later converted to ordinary administrations should pay the same rate as other ordinary administrations, that is to say $150, as they will attract the same OSB supervision costs as other ordinary bankruptcies.
- Last year the OSB processed 2,000 estate claims filed by creditors against the unclaimed dividends trust fund administered by the OSB. Each claim had to be reviewed to determine if the claim was correct and the claimant was, in fact, the rightful owner of the dividend. In cases where companies have subsequently merged or sold their accounts receivable to another company, this analysis can become quite complex and time-consuming.

The OSB's costing indicates that the full cost of this service is roughly $60,000 when salaries, benefits, lease costs and overhead are applied. Therefore a cost of $30 per claim is not unreasonable, and reflects current costs to the OSB.

EVALUATING THE OSB PROPOSALS AGAINST THE GUIDING PRINCIPLES

The next step is to determine how the OSB's proposed fee package rates as a whole against the guiding principles which were published in 'Meeting the Challenge'.

The OSB considers that its proposals are both ***equitable*** and reflect the principle of ***fair share*** as they directly affect the beneficiaries of the system and each type of client or stakeholder – debtor, trustee or creditor – shares in paying the proposed additional funding in a manner which support the government's user-pay principle.

The proposed funding mechanisms are ***simple*** to administer since they dovetail existing mechanisms and do not require the introduction of new administrative procedures that would be costly and cumbersome.

The ***public interest*** is safeguarded since cost-sharing by debtors (higher registration fees), creditors (change to the levy) and trustees (higher licence fees) will allow all three groups to continue to benefit from the bankruptcy and insolvency system.

The funding arrangements chosen for the OSB ***cover its financial requirements*** in a manner which reflects the cost of providing services to clients and stakeholders, and thereby measures up according to the ***value*** yardstick. These measures are consistent with the OSB's intent to eliminate the cost-revenue gap.

The recommendations are also ***flexible***. They do not require complex legislative amendment and could be modified in the future through client consultation and regulatory change.

Finally, the proposals appear to meet the requirement for ***transparency***. Judging by the submissions received in response to 'Meeting the Challenge', it would appear that most clients understand the rationale behind the fee options.

NEXT STEPS

The next step in the consultative process is to request your feedback and comments on both the draft OSB fee proposal package and the concept of a two-tier fee structure as contained in this paper.

The OSB is very grateful for the suggestions and comments received in response to 'Meeting the Challenge' and encourages you to participate once more so that we have a better understanding of your views and can incorporate them into the final fee recommendations which will be developed and published in the *Canada Gazette* and in the *Insolvency Bulletin* later this fall.

Please make your opinions known to the OSB in writing by December 22nd, 1999. Comments and briefs should be addressed to:

Superintendent of Bankruptcy
365 Laurier Avenue West, 8th floor
Ottawa ON K1A OC8

or by fax at: (613) 941-2862
or by e-mail: osb-bsf@ic.gc.ca

Finally, please note that the OSB will be conducting a limited number of hearings for organizations that wish to make presentations. When making a submission to the Superintendent, please indicate if you would like the opportunity to make a presentation late in November.

Annex A

FEEDBACK ANALYSIS REPORT

INTRODUCTION

The purpose of this report is to present the analysis and findings of the OSB Project Team which examined the 34 client and stakeholder briefs received by the Superintendent, the 15 funding options contained in 'Meeting the Challenge', and the funding options suggested by clients.

For analytical and presentation purposes, the report deals with the fee options in four groups (i.e., the four levy options, the three registration fee options, the six trustee licence options, and the two information and administrative together). The report then goes on to examine seven options submitted by clients and stakeholders.

ANALYSIS OF LEVY-BASED FUNDING OPTIONS

Four levy-based funding options were proposed in 'Meeting the Challenge'. The first two proposed increasing the levy on dividends only for summary (consumer) administrations. The other two took a new approach in applying the levy against secured creditors and on total realizable assets, regardless of the type of administration.

The OSB Project Team noted that the Superintendent's levy is the OSB's main source of funding, representing around 60% of total income in recent years. However, this type of revenue has been decreasing because of lower dividend levels. This drop is particularly marked in summary administration files that are nonetheless expected to increase in number. In its analysis, the OSB Project Team also took into consideration the fact that the largest gap between costs and revenues is in summary (consumer) administration.

Table 1 details how the OSB Project Team scored the four levy options against a series of seven evaluation criteria. It should be noted that only negative or positive scoring is indicated on the summary table. Those options deemed to have a neutral effect have been left blank.

CLIENT AND STAKEHOLDER FEEDBACK

On the whole, creditors reacted negatively to any increase in the levy above its current level of 5%, as they felt it could be interpreted as a form of taxation. However, the reaction to option 2 was more favourable since it would reduce the number of low-revenue administrations.

Table 2 shows the number of client and stakeholder briefs for and against each levy funding option.

The following examines each of the four levy options:

Option 1:
Increase the levy payable on summary (consumer) administrations from 5% to 10% of dividends.

Respondents generally had reservations about this funding option, especially as it represents a 100% increase on a single service (summary administrations) that essentially would target one client group — creditors.

Some trustees, on the other hand, suggested that raising the levy on all types of bankruptcies would be appropriate as there were more funds available in ordinary bankruptcies.

The Project Team rated this funding option high for simplicity (as it would be easy to administer), and for public good (as it would not affect debtor access to the system). However, it rated it low in value as it would mean that high asset estates would pay for more than their fair share.

Option 2:
Increase the levy payable on summary administrations to 100% of the first $200 of dividends.

Of the four levy-based funding mechanisms, Option 2 was most favourably received by clients and stakeholders. The Project Team rated it as flexible, simple

to implement and administer, and suited to achieve the OSB's financial objectives.

In addition, this funding mechanism would help reduce the number of summary administrations producing low dividends and similarly reduce administrative expenses associated with processing small cheques from trustees and creditors.

Option 3:
Lower the levy on bankruptcies to 2.25%, but calculate it on total realizable assets, instead of on dividends paid.

Applying levies to total realizable assets rather than to dividends is a new concept. Although this option proposed a lower levy rate, most trustees were opposed to it, as it could jeopardize access to the bankruptcy system by low income debtors.

It was also pointed out that this approach was not consistent with the equity principle since the increase would be borne by those who are not the system's real beneficiaries. In fact, several trustees claimed that priority payment of a file's administrative costs would be prejudicial to their interests, particularly in cases with low-value realizable assets. Finally, although this option could generate the desired level of revenue, it would require amending the Act, which is not feasible at this time.

Option 4:
Lower the levy to 0.5%-1% of dividends, but impose it on all assets in the estate, including those realized by secured creditors.

Like the previous option, this funding mechanism was rejected by respondents on the grounds that it was

Table 1: Cost-sharing Principles Applied to Levies

Options / Assessment Criteria	1. Summary administration 10% levy	2. Summary administration 100% of first $200 of dividends	3. Levy of 2.25% on total realizable assets	4. Levy of 0.5%-1% on all realizable assets including secured creditors' assets
Equity				✘ (Non-beneficiaries)
Simplicity	✓	✓	✘ (Amendment to the Act)	✘ (Amendment to the Act)
Public good	✓	✓	✘ (Accessibility)	✓
Value	✘	✓ (Costs and revenues in balance)	✘	✘
Flexibility		✓ Possible adjustment in the future		
Revenue potential	Average	Average	High	High
Acceptability to clients and stakeholders	✘ Creditors against substantial increase	✓ Creditor and trustee advantages	✘ Creditor and trustee dissent	✘ Secured creditor dissent

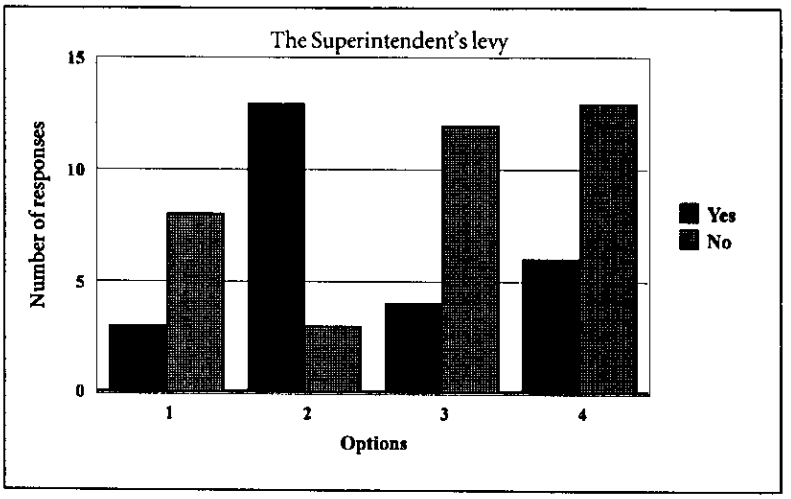
✘ Negative
✓ Positive

unacceptable that secured creditors be obliged to contribute to the system. Some argued that secured creditors are not beneficiaries of a system primarily designed for non-secured creditors. It was felt that this option would induce secured creditors to pursue other avenues of recourse outside the system in order to protect their interests in default situations. They might even increase lending rates to cover additional outlays.

However, the Project Team also noted that some respondents expressed a degree of support for this option on the grounds that secured creditors are either directly or indirectly part of the insolvency system and should be paying their fair share.

Finally, this approach does not seem to be consistent with principles of simplicity and value. It could be difficult to define the assets that would be subject to levy since certain exemptions could be claimed, particularly in the case of real property. It would also be difficult to support this option on revenue-generating grounds, since significant revenue produced by ordinary administrations would be used to offset the financial shortfall in summary administrations.

Table 2: Client and Stakeholder Reaction to Levy-based Options



ANALYSIS OF FUNDING OPTIONS BASED ON REGISTRATION FEES

The OSB Project Team noted that registration fees have several advantages: they are paid at the very beginning of the bankruptcy process and are directly linked to file volumes/workloads; they are more predictable (unlike levy-generated income); and few external factors are likely to upset budget forecasts.

However, the Project Team also noted that severe changes to the registration fee rate could impact negatively on access to the system by low income debtors.

Finally, it should be noted that summary administrations represent the bulk of files opened as well as those showing the largest cost-revenue gap. For this reason, there is little justification for increasing fees for ordinary bankruptcies since, unlike summary administrations, they generally recover their costs.

Table 3 details how the Project Team weighed each of the three registration fee options against the evaluation criteria.

CLIENT AND STAKEHOLDER FEEDBACK

Overall, there was mixed reaction to the idea of increasing registration fees. Creditors supported the use of registration fees to bridge the cost-revenue gap as the method most directly related to the cost of the services being provided. The trustees and consumer debt counsellors, on the other hand, were concerned that those debtors unable to pay the increase would not have access to the system. Some trustees also claimed they would have to cover this additional expense.

As shown in Table 4, respondents' reactions were generally mixed.

Option 5:
Increase the registration fee on summary administrations to $100.

As previously mentioned, respondent reaction was mixed, mainly because of a possible threat to the principle of universal accessibility to the bankruptcy system. On the other hand, even if the suggested increase appears substantial, this funding mechanism is considered to be equitable because it is consistent with the user-pay principle (i.e., individual bankrupts, who are one of the system's beneficiaries, would pay).

Other factors that favour this funding option are its simplicity, the fact that significant additional revenue would be generated, and the further advantage that it

would be paid by consumer estates, where the largest revenue shortfall exists.

Option 6:
Increase the registration fee for all services by 65%.

Respondent reaction to this funding option was also mixed, particularly in terms of the accessibility issue. Although the proposed increase makes no distinction between the various types of bankruptcies, it seems questionable from value and equity standpoints. On the one hand, increased revenue from summary administrations might not be sufficient to reach required levels; on the other hand, additional revenue from registration fees on products other than summary administrations (products that currently cover their costs) would be used to make up the shortfall in summary administration. Consequently, it was the Project Team's view that there was not sufficiently valid justification for this type of cross-funding.

Option 7:
Charge a flat registration fee of $100 for all types of bankruptcies and proposals.

At first sight, three main factors make this funding approach appear attractive: it would be straightforward to manage, easily adjusted in the future and capable of generating the required additional revenues. It also makes no distinction between any of the types of bankruptcies or proposals. However, it would have the same drawbacks as Option 5 in that it doubles the registration fee for summary administrations with all that this implies in terms of the accessibility principle.

Furthermore, although respondents were more or less equally divided in their attitudes to this approach, they did point out a certain paradox: while increasing the summary administration fee to $100 could cause accessibility problems, it would also decrease revenues from the other products.

ANALYSIS OF FUNDING OPTIONS BASED ON TRUSTEE LICENCES AND RELATED SERVICES

There are currently some 875 active insolvency practitioners who provide the OSB with revenue primarily through annual trustee licence fees. Although there are costs incurred in administering the licensing func-

Table 3: Cost-sharing Principles Applied to Registration Fees

Options / Assessment Criteria	5. $100 registration fee for summary administrations	6. Increase registration fee for all services by 65%	7. Charge a flat $100 registration fee for all services
Equity	✓	✗	✗
Simplicity	✓	✓	✓
Public good	Low	Average	Low
Value	✓	✗	✗
Flexibility	✓	✓	✓
Revenue potential	✓	✓	✓
Acceptability to clients and *stakeholders*	✓ Creditors	✓ Creditors	✓ Creditors

✗ Negative
✓ Positive

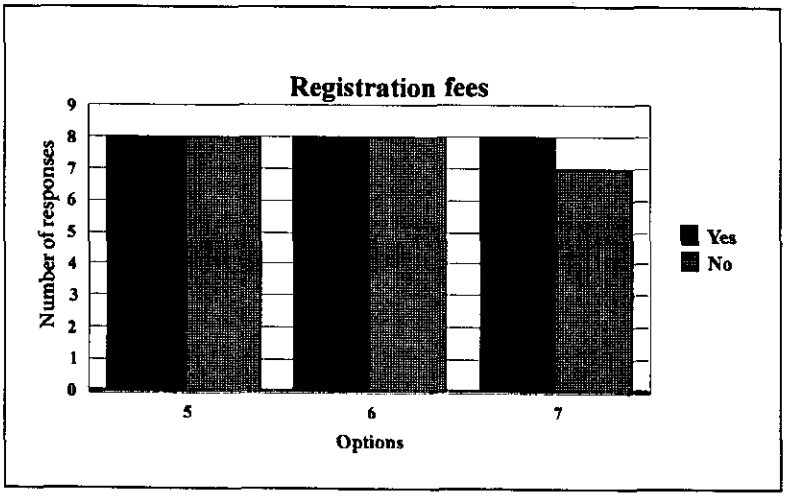
tion, the majority of the costs incurred by the OSB in maintaining professional standards is as a result of trustee discipline and conservatory measures.

Table 5 details how the OSB Project Team scored the six trustee licence fee options against the evaluation criteria. It should be noted that only negative or positive scoring is indicated on the summary table. Those options deemed to have a neutral affect have been left blank.

CLIENT AND STAKEHOLDER FEEDBACK

Overall, trustees indicated that they were open to a 'reasonable' increase in the trustee licence fee. Others expressed concern that because the entire system benefits from a healthy, well functioning trustee community, the cost of maintaining their professional standard should be shared by the other beneficiaries of the bankruptcy system, including creditors, debtors and the Canadian public at large.

Table 4: Client and Stakeholder Reaction to Registration Fee Options



Also, with regard to the high cost of discipline and conservatory measures, trustees indicated that, while they were prepared to pay their fair share, they should not be expected to pay for noncompliant trustees.

Finally, with regard to full cost recovery, trustees voiced their concerns that noncompliant trustees should be detected by the OSB earlier and that, overall, the OSB should be taking measures to reduce its costs and introduce cost-saving measures such as electronic filing.

Table 6 summarizes the positions taken in the briefs received.

Option 8:
Increase the annual renewal fee to maintain a bankruptcy trustee licence by 50%, 100% or 200%.

An increase in annual licence fees is relatively simple to administer and is equitable in itself since all trustees directly benefit from the OSB's services. Such increases would also bring the yearly trustee fee up to the dues levels paid by other professional bodies.

However, trustees are concerned that such increases could be prohibitive since several insolvency practitioners already pay other dues as members of other professions or other provincial or national professional insolvency associations. They also argue that the additional revenue generated would be minimal and only a partial solution to the challenge of full cost recovery.

Option 9:
Establish a sliding scale for trustee licence fees based on the volume and type of estates administered by trustees in the previous year.

The intention behind this option could be considered equitable since trustees administering a large number of files would pay a higher fee than low-volume counterparts. Therefore, should the OSB need to undertake discipline and conservatory measures, the cost would be proportionate to the number of files being administered. On the other hand, some trustees claim that a large number of files does not necessarily mean greater risks as some larger firms regulate themselves.

To a certain extent, this option was acceptable to trustees but was felt to be administratively unwieldy because of the heavy workload.

Option 10:
Impose a surcharge on trustee licence fees based on the cost of discipline and conservatory measures undertaken by the OSB in the previous year.

This option could become administratively complex as it would be difficult to establish the amount of the surcharge. Further, the majority of compliant trustees would have to pay for the misconduct of a minority. Most respondents gave this as their reason for rejecting this option.

The Project Team is, however, very concerned by the need to cover the high costs involved in discipline measures and is very aware of the need to find a solution that would meet both the OSB's financial requirements and the expectations of insolvency practitioners and other stakeholders. The Project Team believes that a special surcharge for delinquent practitioners or a two-tier licensing fee should be considered.

Option 11:
Increase the cost of applying for a trustee licence and charge user fees for various administrative services.

Currently, various services provided by the OSB are included in the annual dues. For example, applications by individual trustees to practise in their own name, to extend a transfer of a licence to another division or to reactivate a licence are all services currently provided by the OSB at no additional charge. These changes often involve not only recording the change in the licensing section of the OSB, but also pulling and amending every open bankruptcy file in the division office(s).

The Project Team recognizes that, as detailed costing of these administrative services has yet to be done, user fees cannot be considered for this round of fee increases. However it also acknowledges that these administrative costs should be studied and considered at a future time.

Table 5: Cost-sharing Principles Applied to Trustee Licences and Related Services

Options / Assessment Criteria	8. Increase annual fees by 50/100/200%	9. Sliding fee scale for licences	10. Licence fee surcharge	11. New fees	12. Performance bond	13. Indemnity fund
Equity	✓	✘ Unequal benefits	✘ Unfair to trustees who abide by the standards	✓	✓	✓
Simplicity	✓	✘	✘		✘	✘
Public good						
Value	✓			✓		✓
Flexibility	✓					
Revenue potential	Low	Low	Low	Low	Low	Low
Acceptability to clients and stakeholders	✓ Open to a reasonable increase	✘ Trustee objections	✘ Trustee objections			✓ CIPA involvement

✘ Negative
✓ Positive

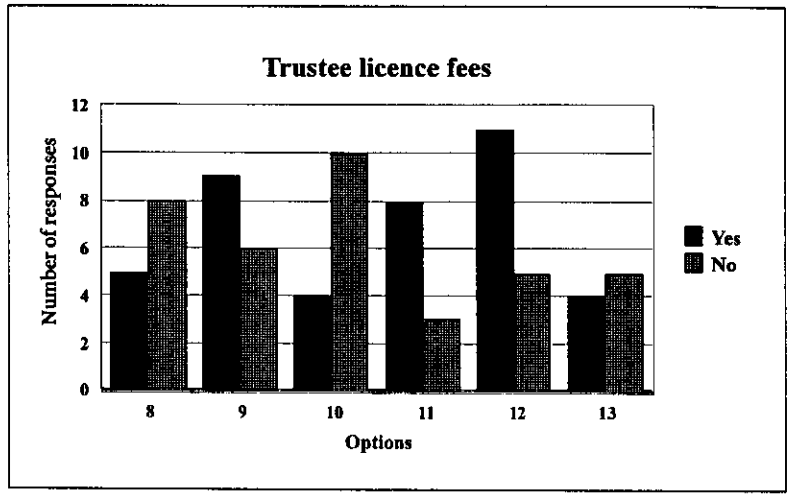
Option 12:
Require trustees to post a performance bond or maintain an insurance policy for $1 million.

Strictly speaking, this option is not a funding mechanism, but rather a means of reducing the costs involved in discipline and conservatory measures.

In the past, however, these instruments have proven to be very costly, litigious and time-consuming for the OSB. Therefore, other more flexible mechanisms are needed.

With regard to trustee reaction, there was some support for this option on the condition that the Canadian Insolvency Practitioners Association (CIPA) be involved in its administration.

Table 6: Client and Stakeholder Reaction to Trustee Licence Options



Option 13:
Require the creation of an indemnity fund to be used to pay for trustee discipline actions and conservatory measures.

As with the previous option, trustees were generally in favour, providing the CIPA is actively involved in its administration.

However, the Project Team acknowledged that while this funding option would reduce the OSB's costs for discipline and conservatory measures, it would require a great deal of further analysis and negotiation with the trustee profession, would be complex to administer and would require a change to the Act to implement.

ANALYSIS OF FUNDING OPTIONS BASED ON INFORMATION SERVICE REVENUES

Option 14 recommended that the OSB develop a range of new information products and services using and exploiting the information contained in the OSB database.

Option 14:
Increase the number of new information products and services.

Few respondents gave their views on this type of funding and those that did noted that little income would be generated and services could be in conflict with similar services provided by other organizations.

In analysing this option, the Project Team noted that the OSB has already taken steps to have a private sector service provider take over responsibility for developing new information products and expanding the OSB database. Therefore, it would be premature at this point (i.e., until the details of the service provider agreement are known) to introduce new fees in this area.

ANALYSIS OF FUNDING OPTIONS THROUGH NEW SERVICES AND FEES

This funding option proposed a series of administrative measures that would enable the OSB to charge fees for services that are currently provided for free. They included:

- processing a change in filing status;
- mediation services;
- conferences and training sessions;
- late charges for overdue accounts;
- processing later claims for initially unclaimed dividends;
- special services provided by OSB members on specific request; and
- use of OSB facilities, equipment or other physical assets.

Option 15:
Set new fees for existing services and introduce services for which fees would be charged.

Virtually all respondents supported these proposals on the basis that service users should pay the cost of the service concerned. However, some doubt was expressed about the amount of additional revenue that would be generated since former users might be inclined to forgo services if they had to pay for them.

For its part, the Project Team noted that some of the changes would probably require amendments to the legislation while the cost of invoicing and collecting other smaller fees would outweigh their benefits. Also, as with the previous funding option, it is possible that the private sector service provider could take over these functions.

However, the Project Team acknowledged the benefits of charging additional fees for a change in filing status and for reviewing claims submitted to the unclaimed dividend trust fund.

ANALYSIS OF FUNDING OPTIONS PROPOSED BY CLIENTS AND STAKEHOLDERS

In addition to providing comments on the 15 options, clients and stakeholders suggested other funding mechanisms. The Project Team reviewed each of these new options against the same evaluation criteria. The following is an overview of the top seven funding options submitted by clients and stakeholders:

- **A fee could be charged when a creditor submits a proof of claim.**

  The Project Team noted that while this would be an effective way of ensuring that creditors involved in the bankruptcy would pay their fair share, it could also discourage creditors (who already stand to lose funds in the bankruptcy) from participating. Therefore, this fee option scored high on equity but low on public good.

- **The OSB could provide and charge for a third debtor counselling session.**

  While this revenue option could generate significant revenues for the OSB and contribute positively to debtor rehabilitation, it would also add to the debtor's costs (which could present an access issue for low income debtors) and move the OSB away from its mandate as a regulator into an area which is currently being served by trustees and bankruptcy and insolvency counsellors.

- **The OSB should limit the time in which unclaimed dividends and undistributed assets are kept in trust, and access all funds exceeding this time frame.**

  It seems fair that unclaimed funds in a cost-recovery process be reinvested in the system and help to reduce costs for all concerned. This easily managed measure could provide sufficient additional revenue as well as good cash flow. However, the Bankruptcy and Insolvency Act would need to be amended to introduce this measure.

- **Increase registration fees for receiverships from $70 to $200–$300.**

  Although raising the registration fee on receiverships would generate additional revenues, it could also serve to discourage registration, which is something the OSB is trying to promote. In addition, the Project Team noted that the current registration fee already covers OSB's costs with respect to receiverships.

- **Double registration fees for cases of repeated bankruptcy.**

  The basis for this suggestion lies in the fact that repeat bankrupts often require greater supervision than first-time bankrupts and should therefore pay for the additional costs incurred by the OSB.

- **Charge trustees for special audits conducted by the OSB.**

  This proposal more or less falls into the category of discipline and conservatory measures, as it would enable the OSB to recover its costs when a special audit of trustee is required. The Project Team noted, however, that while other professions charge their members for audits, current bankruptcy legislation does not provide for this type of funding and it could be a complex and lengthy procedure to negotiate a fee of this nature with the

trustees (as one would have to define acceptable conditions for charging a certain rate).

- **Regulate and charge licence fees for receivers, consumer proposal administrators and bankruptcy and insolvency counsellors and ensure all receivers are licensed trustees.**

  This recommendation was received from a number of trustees, as well as from the CIPA. Their premise is that other players in the insolvency system should also be licensed and regulated by the OSB to ensure their compliance with the Act, and should therefore also pay their fair share of the costs.

The Project Team noted that neither the Superintendent nor the Act currently has the authority to insist that receivers be licensed trustees. It also noted that there are few costs involved in regulating receivers or bankruptcy and insolvency counsellors. Finally, it noted that most consumer proposal administrators are provincial employees and additional fees could serve to deter this practice.

Index of Directives Currently in Effect

NOVEMBER 1998

NUMBER	DIRECTIVES	ISSUED
1R2	Counselling in Insolvency Matters	December 21, 1994
2R	Joint Filing	December 19, 1997
3	Duties of the Bankrupt to Deliver Credit Cards to the Trustee	December 7, 1992
4	Delegation of Tasks	November 17, 1994
5	Estate Funds and Banking	November 17, 1994
6R	Assessment of an Individual Debtor	April 30, 1998
7	Inventory of Estate Assets	February 3, 1997
8R	The Bankruptcy and Insolvency Act Forms	April 30, 1998
9	Fax Utilization	December 19, 1997
10	Redemption of Security and Section 147 Levy of the BIA	December 19, 1997
11	Surplus Income	April 30, 1998
12	Terms of Discharge	April 30, 1998

GENERAL TRANSITIONAL DIRECTIVES

(active Directives which were reissued pursuant to this directive as of July 23, 1993)

NUMBER	DIRECTIVES	ISSUED/REISSUED
3R	Use of related persons to perform services for bankruptcy estates and costs chargeable to the estate	December 15, 1988/ January 10, 1991
4	Trustee Consultation Fees in Non-Business Bankruptcies	January 23rd 1986/ January 10, 1991
5R	Third Party Deposits and Guarantees	December 15, 1988/ January 10, 1991
6	Criminal Investigations	February 17, 1986/ January 10, 1991
7	Retention of Documents by the Trustee	June 19th, 1986/ January 10, 1991
8	Unclaimed Dividends and Undistributed Funds	June 19th, 1986/ January 10, 1991
10	Reporting of Receipts Resulting from the Realization of Assets in Summary Administrations	June 19, 1986/ January 10, 1991
11	Bankruptcy Assistance Program	October 23rd, 1986/ January 10, 1991
12R	Administrative Agreements with Trustees and Receivers	August 12, 1991
13	Estate Bonding	October 23rd, 1986/ January 10, 1991
14R	Proofs of Claim, Proxies and Quorums at the First Meeting of Creditors	December 15, 1988/ January 10, 1991
15R	Costs and Disclosure Associated with the Realization by the Trustee of Secured Creditors' Assets	July 10, 1990/ January 10, 1991
16R	Preparation of the Statement of Affairs	December 15, 1988/ January 10, 1991
18	Informing Creditors of the Result of the Bankrupt's Application for Discharge	June 15, 1987/ January 10, 1991
19R	Publication in Local Newspaper	January 4, 1991
20	Information to be Provided to Creditors in Commercial Proposals	June 15, 1987/ January 10, 1991

NUMBER	DIRECTIVES	ISSUED/REISSUED
22	Realization of Estate Assets	December 22, 1988/ January 10, 1991
23	Notice to Bankrupts and Officers of a Bankrupt Corporation with Regard to their Duties and Status	March 16, 1989/ January 10, 1991
24	Withdrawal of Advances on Trustee Remuneration in Ordinary Bankruptcy Administrations	March 22, 1989/ January 10, 1991
28R	Inactive Trustees	January 4, 1991
29	Non-Resident Office	July 1, 1989/ January 10, 1991
30R	Advertising by Trustees	January 4, 1991
32	Trustee's Report to the Creditors on Preliminary Administration	April 1, 1990/ January 10, 1991

NUMBER	INSOLVENCY CIRCULAR	ISSUED
1	Income Tax Returns	January 21, 1993

REVOKED DIRECTIVES

NUMBER	DIRECTIVES	REPLACED BY
1R	Estate Funds and Banking	5
2R	Definition of Summary and Ordinary Administrations	49(6) of the Act and rule 130
9R2	Income Tax Returns	Insolvency Circular #1 — January 21, 1993
17R2	Surplus Income	Insolvency Circular #2 — April 2, 1993
		Directive 11 — April 30, 1998
21	Documents to be Filed by the Trustee with the Superintendent of Bankruptcy	—
25	Fax Utilization	Directive 9 — December 19, 1997
26R	Delegation of Authority	Directive 4 — November 17, 1994
27	Trustee General Bond	—
31	Taking Inventory of the Bankrupt's Property	Directive 7 — February 3, 1997

Changes to the Insolvency System Concerning Student Loans*

by Andrew Alexander

TABLE OF CONTENTS

I. Introduction 24
II. Summary 24
III. Background 24
IV. Dates of Operation 25
V. Points of Interest 25
The Stay of Proceedings 25
Applications for Discharge 25
Interest 26
Proposals 26
VI. Suggestions to Stakeholders 26
Trustees 26
Creditors 26
VII. Conclusions 27
Appendix A:
Relevant sections from the BIA 28
Appendix B:
Addresses of Student Loans Organizations 29

* Produced with Evan Deboice, with the input and assistance of RAC/ARC, Sue Kinelly (HRDC), and representatives from provincial student loans organizations. This document is provided as a reference only and should not be construed as a legal opinion.

I. INTRODUCTION

On June 18, 1998, the latest change in a series of amendments to various pieces of legislation, including the *Bankruptcy and Insolvency Act* (BIA), was completed with the Royal Assent of Bill C-36.[1] The effect of this change was to make student loans undischargeable on the discharge of a bankrupt, for a period of ten years after the completion of full- or part-time studies.

The issue of student loans has been on the forefront of the insolvency community since before the Bankruptcy and Insolvency Advisory Council hearings of 1993. Since 1990, the value of student loan claims by the Canada Student Loans Program[2] alone has risen from $21 million to over $70 million.[3]

The recognition by the federal government that there existed a problem with the loans system prompted serious reforms to the Canada Student Loans program. In the same effort, similar reforms were brought to provincial student loans programs and the legislation of related economic spheres, including the BIA.

This article shall examine the new student loans provisions of the BIA, describe when these changes take effect and finally, offer suggestions to trustees and creditors on how to deal with the new provisions.

II. SUMMARY

The changes referred to above were made to section 178 of the BIA. For the exact text of these changes, refer to Appendix A.

The changes to the BIA affect bankrupts who have a student loan debt as part of their liabilities. Within certain parameters, a bankrupt will not be released of the student loan debt when that bankrupt is discharged.

As of June 18, 1998, the parameters are:

1. The bankrupt is the beneficiary of a student loan issued under the *Canada Student Loans Act*, the *Canada Student Financial Assistance Act*, or a similar provincial enactment. Loans received to fund educational programs that are not subject to these programs do not fall under paragraph 178(1)(g).
2. The bankrupt was a student at the time of assignment, or the bankrupt was a student within ten years of the assignment.
3. The bankrupt was either a part- or full-time student as defined by the relevant student loan legislation.[4]

The student loan debt and interest thereon would remain an outstanding debt after the bankrupt's discharge, and collection of the debt could then be continued by the creditor.

On the expiration of the ten-year period, the debtor may apply to court to have the loan released. The court has the discretion to release the loan, where the court is satisfied that the bankrupt has acted in good faith with regard to the loan, and that the bankrupt will continue to experience financial difficulty to such an extent that the bankrupt will be unable to repay the loan.

III. BACKGROUND

Student loans do have some special characteristics. They are only made on proof of financial need, and are unsecured. They are expected to be repaid from future earnings, which will presumably be enhanced by the education they enable.

One of the larger concerns of Human Resources Development Canada, the government department responsible for the Canada Student Loans Program, was the issue of ex-students who finished their studies and proceeded shortly to bankruptcy. As such, one of the recommendations towards an eventual amend-

1 Bill C-36, An Act to implement certain provisions of the budget, tabled in Parliament on February 24, 1998. The Bill received Royal Assent on June 18, 1998 and came into force the same day.

2 The CSLP operates under the auspices of Human Resources Development Canada (HRDC). The program has been in existence since 1964.

3 The CSLP does not operate in Quebec or the Northwest Territories. This figure also does not include provincial student loans programs.

4 Where this is an issue in determining whether paragraph 178(1)(g) applies, further clarification should be obtained from the applicable student loan organization. A list of these is included in Appendix B.

ment to the BIA was a modification of section 178, which would make a student loan non-dischargeable in bankruptcy within a two-year period of the completion of studies. This recommendation formed one of the modifications to the BIA in 1995, through Bill C-109, the predecessor to Bill C-5. At the same time, changes by regulation were made to the *Canada Student Loans Act*, which increased "interest relief" provisions from six months to a total of 24 months.[5]

Shortly after Bill C-109 was tabled in 1995, an important change to the Canada Student Loans Program was adopted. Instead of a government-guaranteed system of loans, a risk-shared system was created. Under this new system, rather than the government compensating the participating banks for losses suffered under the program, five percent of the total value of the loan would be paid up front and only limited compensation provisions were allowed, with a result that the participating banks were to share more of the risk regarding potential losses.

Bill C-109 had just been read for the first time in Parliament when another change to the Canada Student Loans Program was adopted. The interest relief provisions of the program were increased from a maximum 24 months to 36 months. Thus, when the two-year provisions in paragraph 178(1)(g) of the BIA came into force on September 30, 1997, it would theoretically have been possible for a debtor to take advantage of the interest relief provisions for at least 24 months (if not 36), and then file an assignment in bankruptcy, effectively avoiding the two-year period in which a student loan would not be released from bankruptcy.

The mandate of the federal budget of 1998 included, among a number of other things, sweeping reforms to the treatment of student loans. In particular, to alleviate the burden of many students facing student loans, a tax credit was allowed for interest payments, the criteria for interest relief were further improved, and after a five-year period, reduction of the principal of a student loan was possible. As a balance to these reforms, and as a further disincentive to choosing bankruptcy over these mechanisms, the period in which a student loan is not released from bankruptcy was increased from two years to ten years following the termination of studies.

IV. DATES OF OPERATION

Although the changes to the release of student loans out of bankruptcy are not retroactive, the implementation of the budget has created a hierarchy of application for the different amendments.

To summarize the applicability of the changes, if a student declared bankruptcy:

before September 30, 1997: A student loan will be released upon the discharge of the bankrupt (although the discharge can be opposed by a creditor).

after September 30, 1997, but before June 18, 1998: A student loan will not be released upon the discharge of the bankrupt if the debtor was a student at, or within two years of, the time of the assignment.

June 18, 1998: A student loan will not be released upon the discharge of the bankrupt if the debtor was a student at, or within ten years of, the time of the assignment.

So, depending on when a debtor became or becomes bankrupt, the student loan obligation may be subject to a different application of law.

V. POINTS OF INTEREST

The Stay of Proceedings

Since a debt arising from a student loan constitutes a provable claim and is an unsecured debt, the stay of proceedings under the BIA will apply. Further collection action on debts not released pursuant to subsection 178(1) of the Act cannot take place until the trustee has been discharged, unless the creditor obtains leave from the court.

Applications for Discharge

A person who has gone bankrupt may make an application to the court to release the student loan(s). In proper terms, this is a request that the court make an order to the effect that subsection 178(1) does not

5 The first six months were still the only months "guaranteed". Interest relief after this period must be applied for, and was granted on the basis of a needs test.

apply in relation to the person's student loan. If the court is satisfied that the bankrupt has acted in good faith with regard to the loan, and that the bankrupt will continue to be unable to repay the loan, it may make such an order, and the student loan will be released.[6]

The application may be made following the expiration of the ten-year period. This does not mean the debtor must wait ten years from filing an assignment, but ten years since finishing or terminating studies. Depending on when the ten-year period ends, the application could be made during or after the administration of the estate. It is not a responsibility of the trustee to make the application, and the application is not a cost to the estate.

As described earlier under "Dates of Operation", where the debtor filed an assignment in bankruptcy between September 30, 1997 and June 17, 1998 the waiting period described above is in fact a two-year period.

Interest

While a creditor may not continue collection activity against the bankrupt during the stay of proceedings, student loans which are subject to paragraph 178(1)(g) continue to accrue interest during that period. The rate of interest is contained in the student loan agreement.

Proposals

The provisions on the non-dischargeability of a student loan debt in a bankruptcy also apply to a proposal made under the BIA. The acceptance of a proposal which includes as a debt a student loan to which paragraph 178(1)(g) would apply if the debtor had gone bankrupt, does not release that debtor from the student loan, unless the creditor to the student loan specifically assents to the release of the loan.

VI. SUGGESTIONS TO STAKEHOLDERS

Trustees

Given that there are separate programs in each province as well as the federal Canada Student Loans Program, a bankrupt may have several different loans owing to different creditors. As well, some loans may be risk-shared with financial institutions as opposed to guaranteed by the federal or provincial government. The bankrupt may not be aware of these particular differences.

The trustee should determine from the bankrupt from which student loan organizations the bankrupt has obtained student loans, and from which financial institutions the money has been loaned. In advising the bankrupt whether or not a student loan will be released, the trustee needs to know the date upon which the student ceased to be a full- or part-time student, with regard to the particular student loan.

The trustee should send a proof of claim form to each financial institution that has given a student loan under a student loans program. The trustee may also wish to send a notice of bankruptcy to the student loans organization.

Supporting documentation for a proof of claim filed by the financial institution should provide the trustee with enough information to confirm whether or not paragraph 178(1)(g) of the Act will apply.

The bankrupt should provide the trustee with such information as the trustee feels necessary to determine the applicability of paragraph 178(1)(g). While it is not an obligation of the trustee to make a determination as to whether the student loan will or will not be released, a debtor considering bankruptcy will in all likelihood wish to know at the beginning of the process, rather than at the end, whether or not he or she will be released from the debt.

Creditors

Creditors to a student loan are entitled to a dividend from the bankrupt estate, regardless whether or not the loan will be released upon the discharge of the bankrupt. If a creditor wishes to be eligible to receive a dividend, that creditor must file a proof of claim with the trustee before the trustee proceeds to a discharge. The claim should be in the amount of the principal outstanding plus any applicable interest, as of the date of bankruptcy.

6 The exact criteria for the court's decision are present at paragraphs 178(1.1)(a) and (b) of the BIA.

It is not mandatory for a creditor to file a proof of claim with the trustee in order for the creditor to take proceedings for recovery of a student loan that is not released, after the bankrupt's discharge.

There may be cases where a financial institution is indemnified by the student loan program for the loss on a particular student loan. In this case, the student loans organization should be properly identified as the creditor, and if necessary, an additional proof of claim form should be sent to the organization upon request.

If proofs of claim are filed by both the financial institution and the student loan program in regards to the same loan, the trustee may determine, pursuant to section 135 of the BIA, whether one or both claims are entitled to receive a dividend.

On the bankruptcy of an individual with a student loan, creditors are stayed from proceeding with any collection until the discharge of the trustee of the estate. If the creditor wishes to initiate a collection action before the discharge of the trustee, that creditor must apply to the court to lift the stay of proceedings, pursuant to section 69.4 of the BIA.

VII. CONCLUSIONS

The goal of the recent changes concerning student loans is to provide an incentive to using debt-management mechanisms set out in the student loans process, at the same time, providing a disincentive to bankruptcy. These changes encourage debtors to maintain their responsibility concerning student loans.

The law gives no redress for exceptional situations. Consequently, the debtor must wait until the end of the ten-year period before making an application to court for release of a student loan debt.

The measures implemented in the Canada Student Loans Program to alleviate the financial burden of a debtor with a student loan will certainly assist a large number of debtors. At the same time, it is equally certain that the ten-year period in which a student loan debt will not be released in bankruptcy should cause many debtors to re-think their strategy when dealing with a student loan debt.

Appendix A

RELEVANT SECTIONS FROM THE BIA

Debts not released by order of discharge

178. (1) An order of discharge does not release the bankrupt from

...

(g) any debt or obligation in respect of a loan made under the Canada Student Loans Act, the Canada Student Financial Assistance Act or any enactment of a province that provides for loans or guarantees of loans to students where the date of bankruptcy of the bankrupt occurred

(i) before the date on which the bankrupt ceased to be a full- or part-time student, as the case may be, under the applicable Act or enactment, or

(ii) within ten years after the date on which the bankrupt ceased to be a full- or part-time student; or

(h) any debt for interest owed in relation to an amount referred to in any of paragraphs (a) to (g).

Court may order non-application of subsection (1)

(1.1) At any time after ten 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 loan; and

(b) the bankrupt has and will continue to experience financial difficulty to such an extent that the bankrupt will be unable to pay the liabilities under the loan.

Appendix B

ADDRESSES OF STUDENT LOANS ORGANIZATIONS

Canada Student Loans
Human Resources Development Canada
Learning and Literacy Directorate
P.O. Box 2090
Station D, Ottawa ON K1P 6C6
Telephone: (819) 994-1844

British Columbia
Loan Administration Branch
Ministry of Finance and Corporate Relations
P.O. Box 9401
Station: Provincial Government
Victoria BC V8W 9V1
Telephone: (250) 387-5381

Alberta
Province of Alberta
Loans Administration Unit
P.O. Box 28000
Station: Main
Edmonton AB T5J 4R4
Telephone: (403) 427-2301

Saskatchewan
Post Secondary Education & Skills Training
Student Financial Assistance Branch
3085 Albert Street
Regina SA S4P 3V7
Telephone: (306) 787-5620

Manitoba
Manitoba Student Financial Assistance Branch
693 Taylor Avenue
Winnipeg MA R3M 3T9
Telephone: (204) 945-6321

Ontario
Ontario Student Assistance Program
P.O. Box 4500
Thunder Bay ON P7B 6G9
Telephone: (807) 343-7260

Quebec
Direction de la gestion des prêts
Aide financière aux études
Ministère de l'Éducation
1035, rue De La Chevrotière
22ème étage
Québec PQ G1R 5A5
Telephone: (418) 643-3750

New Brunswick
Student Services Branch
Department of Advanced Education and Labour
P.O. Box 600
Fredericton NB E3B 5H1
Telephone: (800) 667-5626

Prince Edward Island
Student Aid
Department of Education
P.O. Box 2000
Charlottetown PEI C1A 7N8
Telephone: (902) 368-4640

Nova Scotia
Student Assistance Office
Department of Education and Culture
P.O. Box 2290
Halifax NS B3J 3C8
Telephone: (902) 424-5168

Newfoundland
Student Aid
Department of Education
P.O. Box 8700
St. John's NF A1B 4J6
Telephone: (709) 729-5849

Northwest Territories
Government of the Northwest Territories
Senior Collection Officer
Financial Management Board
P.O. Box 1320
Yellowknife NWT X1A 2L9
Telephone: (403) 920-8002

Making Peace on the Bankruptcy Battlefield

CONSUMER BANKRUPTCY MEDIATION UNDER THE BANKRUPTCY AND INSOLVENCY ACT*

by Stanley J. Kershman

1. MANDATING MEDIATION

Battlefields are ugly places. They take their toll on the combatants, both physically and psychologically. Traditionally, the court system has been a battlefield in the view of many clients. Mediation, however, has the potential to replace battlefields with peace tables.

Mediation's success in offering an alternative to settling battles in court has led to its increasing use in legal proceedings. The 1997 revisions to the Bankruptcy and Insolvency Act (BIA) under Bill C-5 recognized this by mandating mediation's availability for specific disputes within consumer bankruptcies. This allows debtors, creditors and trustees to request mediation to resolve these disputes, encouraging the parties involved to sit down together, to talk, and to come to an agreement of their own making.

Communication is the foundation of mediation, and provides an environment in which the parties can progress beyond conflict, towards compromise. Practical, workable solutions can result, with the parties more likely to fulfill their obligations than if a court had imposed a solution upon them. Further advantages of mediation include the confidential nature of the mediation process, the potential for reducing hostility between the parties, thereby salvaging a business or personal relationship, and avoiding court hearings thus reducing time and expense for the parties involved, and for the court system as a whole.

The BIA now makes mediation available, under certain conditions, in two consumer bankruptcy situations:

(i) where the amount of a bankrupt's surplus income is in dispute; and

(ii) where the bankrupt's discharge is opposed.

2. THE SURPLUS INCOME FLAG OF TRUCE

Income is considered surplus when it is over and above the amount necessary to enable the bankrupt to maintain a reasonable standard of living, as based on the standards set out by the Office of the Superintendent of Bankruptcy (OSB) in Directive Number 11 on surplus income.

The BIA amendments that deal with this subject were designed to increase debtors' responsibilities for using surplus income to repay creditors, and to ensure a consistent, yet flexible approach for trustees to use in determining surplus income.

The trustee calculates a bankrupt's surplus income by first subtracting from their total income the expenses associated with personal and family situations such as statutory payments of income tax and pension deductions, child or spousal support, child care, medical care, court fines, and debts not subject to a stay of proceedings. [BIA ss 68(3)]

Once the bankrupt's net monthly income has thus been determined, the trustee uses the standards chart

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at Appendix A in OSB Directive Number 11 to calculate the portion of this income that is considered surplus. Where the surplus is $100 and above, but less than $1,000, the trustee assesses the surplus income payment to creditors at 50 percent of the surplus; where the surplus income is $1,000 and above, the trustee assesses the payment to creditors at 50 to 75 percent of the surplus. [OSB Directive #11]

Should the bankrupt's personal or family situation change, or should the Official Receiver make a recommendation to bring the surplus income payment in line with Directive Number 11, the trustee can amend the surplus income that the bankrupt has to pay his creditors. [BIA ss 68(4) and (5)]

If the bankrupt disagrees with the trustee's determination of the surplus income payments, the trustee must automatically send a request to the Official Receiver for mediation to resolve the disagreement. A copy of this request also goes to the bankrupt. [BIA ss 68(6)]

A creditor who disagrees with the surplus income payment may also request mediation within the 30-day period after either the date of bankruptcy, or the date that the payment amount was amended. The trustee, within five days after the end of this 30-day period, requests mediation via the Official Receiver and sends a copy of this request to the bankrupt and the creditor(s) requesting the mediation. [BIA ss 68(7)]

In both cases, the bankrupt's most recent income and expenses statement must accompany the trustee's mediation request. It should be noted at this point that mediation is available for surplus income situations whether or not this bankruptcy is the bankrupt's first.

3. THE BANKRUPTCY DISCHARGE FLAG OF TRUCE

The BIA also requires the trustee, when preparing and filing the report under section 170 of the BIA, to recommend whether or not the bankrupt should be discharged with any conditions. The report must be filed within eight months following the date of the receiving order or assignment. Amendments to the Act have created clear, consistent guidelines for trustees to follow in making this recommendation, and have also succeeded in alleviating the demands on the court system: discharges, whether conditional or unconditional, may no longer automatically require a court appearance. [BIA ss 168.1(1)(a)(f) and ss 170.1(8)]

The trustee recommends a conditional discharge for a period of up to twelve months if he or she believes:

> *that the bankrupt has not made the required surplus income payments; that the total amount paid into the bankrupt's estate for creditors is small compared to the bankrupt's debts or financial resources; or that the bankrupt could have chosen to file a viable proposal at the time of assessment but instead chose bankruptcy.* [BIA ss 170.1(1) and OSB Directive 12 s.5(1)]

At this time, the trustee will also determine further surplus income payments, along with their frequency during the conditional discharge period. It should be noted that the recommendation for a conditional discharge is deemed an opposition to the discharge. [BIA 170.1(3)] If the bankrupt agrees with the trustee's recommendation, and the discharge is unopposed by either creditors or the OSB, the trustee's recommendation becomes the bankrupt's conditional discharge: no court appearance or hearing is necessary.

If the bankrupt disagrees with the recommendation, and if this bankruptcy is the bankrupt's first, he or she may request mediation: the request must be in writing, and must be sent to the trustee before the end of the ninth month after bankruptcy. [BIA ss 170.1(4)]

The trustee notifies the Official Receiver of the mediation request within five days after the end of the nine-month bankruptcy period. (The bankrupt's most recent income and expense statement is also forwarded with this notification.) The trustee would also file a mediation request in the case where either a creditor or the trustee opposes the discharge at least in part because the bankrupt has failed to pay surplus income amounts, or because bankruptcy was chosen over a viable proposal. Such an opposition to discharge is automatically deemed a request for mediation. [BIA ss 170.1(5) and 173(1)(m) and (n)]

Under these terms, debtors have a greater incentive to comply with surplus income payments, and to file a proposal where one is possible: if they do not, they can expect to remain in bankruptcy for a longer period than the standard nine months.

4. MEDIATION PREPARATION

When mediation is requested, the Official Receiver appoints a mediator, either an employee from a Division Office (including Division Offices outside the bankruptcy division where the proceedings began) or a mediation-trained or experienced individual whom the Superintendent considers qualified.

The bankrupt, the trustee or trustee's representative, and any creditors who requested the mediation are also parties to the mediation. All of these parties must have the authority to make decisions and sign any required documents, including the mediation settlement agreement: in other words, the decision-makers must be present at the peace table.

Any of the parties may be represented by legal counsel. In addition, a bankrupt's spouse or friend may also attend the mediation: in many cases, this can provide moral or emotional support, a calming influence, and a source of ideas during caucusing periods. In a creditor-opposed mediation, trustees have a particularly valuable role to play: they can act as advisors to those affected by the bankruptcy, proposing options that the other parties might not have considered, and providing a voice of fairness.

The optimum mediation setting is one where the parties are face to face, at the same table. However, the mediator can choose to conduct the mediation in other ways, either by telephone conference call, or by other communication technologies that allow all parties to talk to each other, such as video-conferencing. These alternatives are appropriate where the parties are, for example, in remote locations. Whether or not the mediator chooses to conduct the mediation with all parties in the same room, the location or locations are either Division Offices, or neutral sites specified by the mediator.

The date for mediation must be set for no later than 45 days after the Official Receiver received the trustee's mediation request. [BIA Rule 105(4)] To ensure that the parties are as prepared as possible, the mediator sends the bankrupt, the trustee, and any creditors requesting mediation, a copy of the notice of mediation. This is sent at least 15 days prior to the mediation date (unless all the parties have agreed to a different deadline). Included in the material should be the OSB brochure All About Bankruptcy Mediation, which is aimed primarily at ensuring that the bankrupt has access to the basics of what mediation is about.

At any time before the mediation has begun, the mediator can reschedule the mediation to take into account such unavoidable circumstances as illness or family emergencies among the parties involved. [BIA Rule 105(8)] The new time must be set for within ten days after the date on which the rescheduling occurs, and the mediator must inform all the parties of the new time and location. This notification can be verbal. [BIA Rule 105(10)]

5. ADJOURNING THE MEDIATION

If the mediation has started, or is just about to start, a number of factors can result in the mediator's decision to adjourn the process. As in the case of rescheduling, the date of the new mediation session must be within ten days of the adjournment date, and the mediator must notify the parties, at least verbally, of the new time and place. [BIA Rule 105(10) and (11)]

a. Further Negotiations or Information Needed

If one or more of the parties requests an adjournment, and the mediator has reasonable grounds to believe that further negotiations between the parties or the provision of additional information would benefit the process, he or she can reschedule the session. [BIA Rule 105(9)(a)]

b. Inability to Continue

If the mediator believes that one of the parties, on reasonable grounds, cannot continue the mediation for a certain period of time, the mediation can be adjourned. However, there is a difference in a mediation where a creditor has opposed the bankrupt's discharge on the basis of the bankrupt not having paid the required surplus income, or having chosen bankruptcy rather than making a viable proposal. Here, the inability of the trustee (or the trustee's representative) to continue with the mediation is NOT grounds for adjournment. As long as the bankrupt and at least one of the creditors who requested mediation are present and can continue, the mediation proceeds. [BIA Rule 105(9)(b) and (13)]

c. Creditor Non-Appearance

Where one or more creditors have requested mediation, and none of them attend the mediation, the me-

diator may adjourn the proceedings if he or she believes that at least one of the creditors is absent in good faith: that is, that they are not attempting to needlessly delay the mediation, or give the process a poor reputation. [BIA Rule 105(9)(c)]

d. Bankruptcy Discharge: Bankrupt or Creditor Non-Appearance

As noted above, the failure of the trustee (or trustee's representative)to appear at the mediation is not grounds for the adjournment of a bankruptcy discharge mediation that has been requested by one or more creditors based on the bankrupt's not having paid required surplus income amounts, or having chosen bankruptcy over making a viable proposal.

However, if either the bankrupt or at least one of the creditors fails to appear at a bankruptcy discharge mediation, the mediator can adjourn it if he or she believes the non-appearing parties are acting in good faith, with valid reasons for their absence. [BIA Rule 105(9)(d)]

e. All Other Cases: Bankrupt or Trustee Non-Appearance

The cases for adjournment have already dealt with the non-appearance at the mediation of the creditors who requested it, and with the non-appearance of the trustee in the specific case of a creditor-requested bankruptcy discharge.

In all other cases, where the bankrupt or trustee is unable to appear or continue for reasons the mediator believes are based on good faith, the mediator adjourns the mediation. [BIA Rule 105(9)(e)]

6. CANCELLING THE MEDIATION

Either after the mediation has begun, or as it is about to start, it may become apparent to the mediator that the process cannot continue. There are several circumstances that would cause the complete cancellation of the mediation process, rather than simply an adjournment.

a. Abuse of the Rescheduling Process

The mediator cancels the mediation if he or she has reasonable grounds to believe that a party is abusing the rescheduling process. Such abuse might include attempting to delay the process to create inconvenience or additional expense to other parties, or to delay the start date for compliance with a mediation agreement or court order. [BIA Rule 105(12)(b)]

b. Second Adjournment

If an adjournment has already taken place, and another adjournment is requested or a circumstance occurs that triggers an adjournment (as noted in 5a to e), the mediation must be cancelled. Second adjournments are not permitted. [BIA Rule 105(12)(c)]

c. Inability to Continue

If the mediator believes that one of the parties cannot continue the mediation, the mediation is cancelled. There is one exception: the inability of a trustee to attend a creditor-requested mediation dealing with bankruptcy discharge opposition on the grounds that the bankrupt failed to make required surplus income payments, or chose bankruptcy over making a viable proposal. Here, even if the trustee is absent, the mediation continues. [BIA Rule 105(12)(d)]

d. Creditor Non-Appearance in Bad Faith

In a mediation that was requested by one or more creditors, if none of the creditors appear, and the mediator reasonably believes that all of the creditors are acting in bad faith, the mediation is cancelled. Bad faith would involve using the non-appearance as a delaying tactic, or to bring the mediation process into disrepute. [BIA Rule 105(12)(e)]

e. Bankruptcy Discharge: Bankrupt or Creditor Non-Appearance

As noted above, the failure of the trustee to appear at the mediation is not necessarily grounds to cancel a creditor-requested bankruptcy discharge mediation. However, if either the bankrupt or at least one of the creditors fails to appear at such a mediation proceeding, and the mediator believes that the non-appearance is in bad faith, the mediator cancels the mediation. [BIA Rule 105(12)(f)]

f. All Other Cases: Bankrupt or Trustee Non-Appearance

We have seen that mediation cancellation can take place when none of the creditors who requested the mediation appear, with none of them having reasonable excuses for their absence. The non-appearance of the trustee in the specific case of a creditor-requested

bankruptcy discharge, meanwhile, does not necessarily trigger a cancellation. In all other cases, where the bankrupt or trustee is unable to appear or continue for reasons the mediator believes are based on bad faith, the mediator cancels the mediation. [BIA Rule 105(12)(g)]

g. Bankruptcy Discharge: Outstanding Opposition

If a creditor or trustee opposes a bankruptcy discharge under the grounds of an outstanding opposition (other than those involving non-payment of surplus income or bankruptcy in lieu of a viable proposal), and if it is unlikely that the opposition will be dropped, the mediator cancels the mediation. [BIA Rule 105(12)(a)] In such cases, the outstanding opposition will result in a court hearing regardless of the mediation's outcome, so continuing would not be productive.

The grounds for an outstanding opposition include that the bankrupt:

- is responsible for a situation in which he or she does not have assets equalling fifty cents on the dollar on the amount of the unsecured liabilities;
- did not keep proper books of account during a three-year period prior to the bankruptcy;
- continued to do business after becoming insolvent;
- failed to account for not having sufficient assets to cover liabilities;
- brought on, or contributed, to the situation through rash speculating, extravagant living or culpable neglect;
- caused creditors unnecessary expenses due to a frivolous defence against an action properly brought;
- began a frivolous legal action, gave some creditors undue preference, or intentionally reduced assets to fifty cents on the dollar of the unsecured liabilities in the three months prior to bankruptcy;
- has previously been bankrupt or made a proposal to creditors;
- has been guilty of fraud, or fraudulent breach of trust;
- committed any offence under the BIA; or
- failed to comply with orders or duties imposed by the court.

When a mediation has been cancelled, the mediator notifies the Division Office and the parties of the cancellation, and the reasons for it. In most cases, the cancellation means that the issues have not been resolved, and no agreement has been reached between the parties. [BIA Rule 105(15)]

Where surplus income is at issue, the trustee's next action may be to apply for a court hearing. The trustee must apply for a court hearing, however, if a creditor, the Official Receiver, or an inspector requests it. [BIA ss 68(10)]

In bankruptcy discharge situations, the trustee must apply for a court hearing without delay, with one exception. Where the mediation was cancelled due to the non-appearance in bad faith of the creditors who requested the mediation, the opposition to the discharge is automatically deemed withdrawn, the issues submitted to mediation are considered to have been resolved, and the discharge continues without creditor opposition. [BIA Rule 105(14)]

7. THE MEDIATION PROCESS

Mediation moves through four progressive stages, each of which reinforces the positive nature of the session, moves the parties forward, and lays the groundwork for the next stage:

Stage One — Introducing the Process: this ensures that the parties understand the mediation process, and their part in it;

Stage Two — Identifying the Issues: here, the issues involved in either setting surplus income amounts or determining conditional bankruptcy discharges are discussed;

Stage Three — Exploring and Resolving the Issues: this stage explores how and why each party feels the way they do, and begins the negotiating process; and

Stage Four — Finalizing the Settlement: compromises reached in stage three become agreements in stage four.

8. WHEN MEDIATION FAILS

If the mediation is unresolved for any other reason than cancellation, the mediator notifies the Division Office and the parties involved that the issues submitted to mediation were not resolved, and an agreement was not reached. [BIA Rule 105(19)] With surplus income cases, the trustee may apply to the court for a hearing; however, if a creditor, the Official

Receiver or an inspector has requested a court hearing, the trustee must apply to the court. [BIA ss 68(10)] Where the mediation involves bankruptcy discharge, the trustee must immediately apply to the court for a hearing. [BIA ss 170.1(7)]

9. WHEN MEDIATION SUCCEEDS

If the parties come to a resolution, a mediation settlement agreement is drawn up and signed by each party, with copies sent by the mediator to the Division Office and all parties involved. The agreement is considered binding on the parties, although it is subject to any subsequent court order that applies to the bankrupt's situation. [BIA Rule 105(17)] Payments decided upon as part of the mediation settlement agreement must be made by the bankrupt to the trustee, who deposits them into the estate for distribution to the creditors. [BIA Rule 105(18)]

Should the bankrupt not comply with the mediation settlement agreement, the trustee requests a court hearing. [BIA ss 68(10) and 170.1(7)]

10. BANKRUPTCY MEDIATION: THE PEACE DIVIDEND

The 1997 changes to the BIA generally increase the responsibility of the bankrupt with respect to settling his or her affairs, and clarify the standards for trustees who are dealing with surplus income and bankruptcy discharge issues.

A key point that arose during the Bankruptcy and Insolvency Advisory Committee (BIAC) and stakeholder discussions regarding these changes was to avoid placing any additional burdens on the court system, and in fact to alleviate the system's overloading if possible.

Bankruptcy mediation has the potential to achieve these aims, through reducing necessary court appearances, and increasing compliance with bankruptcy conditions. It achieves much more than this, however. By providing a catalyst for conflict to become compromise, mediation works for the bankrupt, for the creditors, for the trustee and for the court system.

Simply stated, mediation brings a white flag of truce to the bankruptcy battlefield, and creates winning solutions for all involved.

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Mr. Kershman is a member of the Bankruptcy and Insolvency Advisory Committee (BIAC) established by the Government of Canada to review existing legislation and recommend changes; he also prepared the bankruptcy mediation models for surplus income and bankruptcy discharges for the Office of the Superintendent of Bankruptcy. He has written and lectured extensively on bankruptcy, insolvency and mediation, and is regularly called upon to give expert advice in print, radio and television media.

Mr. Kershman is also a Deputy Judge of the Ontario Court (General Division), Small Claims Court and a member of the Carleton County Law Association, Canadian Bar Association and American Bar Association.

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Changing Trends in Canadian Bankrupt Demographics: Comparison of 1982 and 1994 National Studies

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Over the years, the various Canadian Superintendents of Bankruptcy have been interested in profiling the socio-economic characteristics of bankrupts, intending to use this information to balance the traditional economic and legal viewpoints of bankruptcy. There were stereotypical perceptions, and anecdotal evidence, of who constitutes an insolvent person applying for bankruptcy but little empirical evidence. This paper will profile and compare the first two national surveys of Canadian bankrupts, focusing on demographic and financial characteristics. The fate of insolvent Canadians seems to be more and more in the hands of bankruptcy trustees and good policy regulating this service to citizens necessitates profiles of them and their circumstances.

ESCALATING CANADIAN BANKRUPTCY RATES

Of all bankruptcies that occur in Canada, 80% are personal, with the other 20% related to business. Even though governments and economists predicted that a stronger national economy should translate into a decrease in personal bankruptcies in 1996, this did not occur (Flavelle, 1996; Industry Canada, 1996). A record 79,631 consumer bankruptcies occurred in Canada in 1996, up 22% from 1995 (Toulin, 1997). As of 1998, over 80,000 people had entered bankruptcy. Since 1992, 1,800 people have opted for a consumer proposal; 70% of these were agreed to by creditors and are under way (Industry Canada).

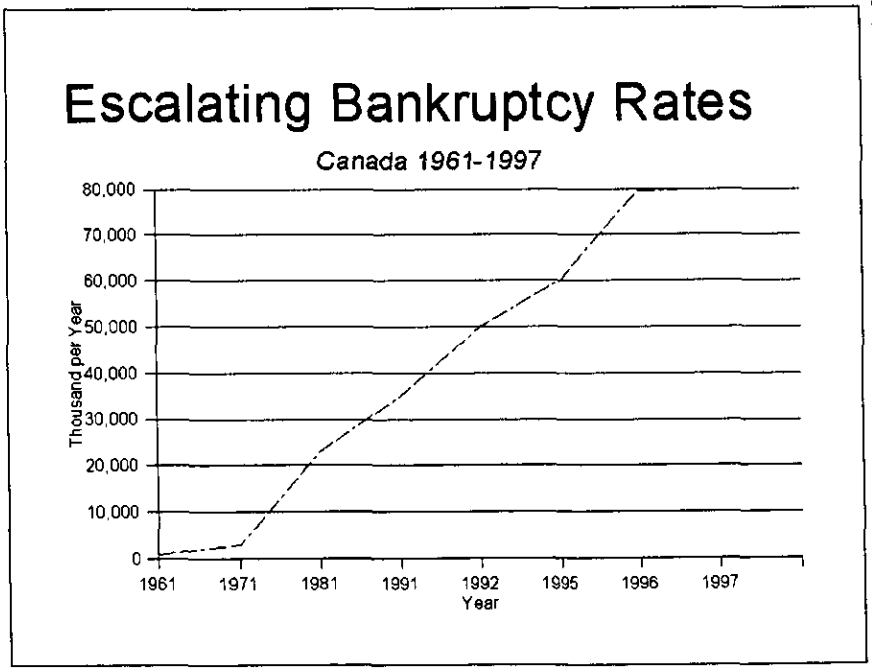

Figure 1
Escalating bankruptcy rates in Canada 1961-1997 (Brighton and Connidis, 1982 and Industry Canada, 1996)

About one in 400 Canadians filed for bankruptcy in 1996, up from one in 10,000 in 1966 (Lorinc, 1996). The number of bankrupts has been increasing exponentially over the last 35 years from 1,000 in 1961, to 23,000 in 1981, 35,000 in 1990 and over 50,000 in 1992. Personal bankruptcies for 1995 were over three times those for 1980. Bankruptcies per thousand households have more than doubled since 1986. They have increased at a compound annual rate of 8.9% per year during a five-year time frame (1990–95) and continue to follow this trend (Brighton and Connidis, 1982; Industry Canada, 1996; Liptrap, 1996; MEPA/MEA, 1996) (see Figure 1). In the late 1980s, one in ten bankrupts were repeats with third, fourth and even fifth time repeats becoming more common whereas repeats were an anomaly in the early 1970s (Clare, 1990).

RATIONALE AND METHODOLOGY OF THE FIRST TWO CANADIAN BANKRUPTCY STUDIES

This paper will compare the demographic and socio-economic profile of bankrupts tendered in 1982 by Brighton and Connidis (using 1977 data) with the 1994 profile generated by the National Counselling Directive Working Group on Mandatory Counselling for Bankrupts (1994). Prior to the Brighton and Connidis study, no national statistics profiling the demographics of Canadian bankrupts existed except for the annual reports prepared by the Bankruptcy Branch of Consumer and Corporate Affairs Canada (CCAC), now Industry Canada. Brighton and Connidis's results were the standard profile for years. This state of affairs is indeed signifi-

cant since Canada has had a bankruptcy act since 1919 (Klotz, 1994), but revisions had not occurred to the act for at least 45 years (Bennett, 1992). No one had ever captured a portrait of bankrupts until 1982. For clarification, Schwartz and Anderson released a 1998 study using data from two months in 1997. They offer some comparison with Brighton and Connidis's results but do not delve into the 1994 Working Group results nor do they compare Brighton and Connidis with the Working Group. This study fills that gap and sets the stages for a tri-level comparative analysis in the near future.

The rationale and methodology for the 1982 and 1994 studies are similar enough to merit a comparison of results, although 17 years lapsed between the first study of demographic profiles in 1977, reported in Brighton and Connidis (1982), and the second profile in 1994 (Carriere, 1994; Forde and Roberts, 1994a,b; National Counselling Directive Working Group, 1994). The 1982 study was conducted because these types of data had never before been collected in Canada. The 1994 study was the first comprehensive national survey of Canadian bankrupts since Brighton and Connidis and the only one that measures the impact of the 1992 refinements to the *Bankruptcy Act*. Among other changes, the *Bankruptcy Act* was renamed the *Bankruptcy and Insolvency Act* (BIA) and revised to mandate financial counselling prior to an unconditional discharge from bankruptcy or a consumer proposal (Bennett, 1992; Industry Canada, 1994a,b; McGregor and Berry, 1997a,b; Salyzyn, 1992). In 1977, two types of bankruptcies were allowed, private trustee and federal government trustee (FITA).[1] In 1994, insolvent consumers could opt for bankruptcy, a consumer proposal or, in five provinces, the Orderly Payment of Debt (OPD) Program.

Both studies captured data relevant to prevailing types of bankruptcies, and both ensured regional representation and national representation. The 1977 sample frame provided a demographic profile of 1,509 bankrupts from 12,772 files (10%). The 1994 sample frame yielded 5,241 from over 50,000 files (10%), with similar steps taken to ensure regional representation. Both collected data from existing bankruptcy files in the district superintendent's offices. The 1977 study did not collect any primary data from new filers. It did capture occupational status but not educational level. The 1994 study also used existing data in the files on record and collected primary data about occupation and education via telephone interviews since this was not collected in the files at the time of filing.

A comparison of the results of these two studies leads to an interpretation of how the demographics of bankrupts have changed over the last 15 years. Possible explanations for these shifts will be integrated into the results section, followed by concluding comments on what these demographic shifts mean for the collection of stakeholders affecting insolvent Canadians.

RESULTS AND CONTEXTUAL DISCUSSION

Since very similar socio-economic data were collected in both studies, using compatible methodologies, it is possible to compare results across the two studies. At first glance, the *general* profile of Canadian bankrupts does not really seem to have changed in 17 years. Using the highest frequencies in Tables 1 and 2, it would appear that the average bankrupt is still a male in his thirties, married with children. He has high school or less, is employed in an unskilled or semi-skilled job and earns a net income of $13,000. He claims that he became insolvent because of consumer debt (mismanagement of money, lack of a budget and excessive borrowing) and owes most of this debt to financial institutions in the form of consumer loans, credit cards, utilities and private individuals (friends and families). His liabilities total

1 In the late 1970s, consumers had two ways to file for bankruptcy, either through a private trustee or under the Federal Insolvency Trustee Agency (FITA). The latter was implemented in 1972 as a way to make bankruptcy available to those who could not afford a private trustee. Prior to that, debtors had to meet certain income and asset tests before they were able to benefit from the bankruptcy program. By 1978, the FITA came to an end, not because it had not worked, but because it had been so efficient that private trustees had opted to administer all bankruptcies, even those which did not have enough monies in their estate to pay the fees. The FITA was still in existence in 1977, the year in which Brighton and Connidis collected their data, and they claim that its success actually contributed to the marked increase in consumer bankruptcies from 1972 to the early 1980s compared to the years between 1960 and 1970.

Table 1
Comparison of Canadian bankruptcy demographic profiles from 1977 and 1994

Socio-demographic variables	Brighton and Connidis, 1982 (data collected in 1977)	National Working Group Survey (data collected in 1994)
Age	Average age 33.6	Average age 38
	20–29 . . . . . 39.2% 30–39 . . . . . 38.2% 40–49 . . . . . 14.3% 50–59 . . . . . 6.2% 60+ 1.5%	20–29 . . . . . 21.3% 30–39 . . . . . 37.4% 40–49 . . . . . 26.9% 50–59 . . . . . 10.6% 60+ 3.8%
Gender	Male . . . . . 66% Female . . . . . 27% Joint filings . . . . . 6% (mainly Quebec)	Male . . . . . 61% Female 39%
Marital Status	Married . . . . . 64% Separated (13%)/divorced (6%) . . . . . 19% Common-law (not measured in 1977) Single . . . . . 10% Widowed 1%	Married . . . . . 42.7% Separated (14.3%)/ divorced (13.5%) . . . . . 27.8% Common-law . . . . . 21.1% Single . . . . . 6.8% Widowed 1.5%
Dependents	No children . . . . . 38% one . . . . . 11% 2–3 . . . . . 34% 4 or more . . . . . 16% Totals 61% with children	None under 15 . . . 57% One . . . . . 19% 2–3 . . . . . 23% 4 or more . . . . . 2% Totals 43% with children None over 16 . 77% One . . . . . 17% 2 . . . . . 5% 3 or more . . . . . 1% Totals 23% with children
Education	not measured in 1977 but anecdotal evidence was high school or less	High school or less . . . . . 57.5% Non-university education . . . . . 23.4% University 19.1%
Occupation	Unskilled clerical/sales/service/manual labour . . . . . 38.0% Semi Skilled clerical/sales/service/craft/trade . . . . . 29.0% Skilled clerical/sales/service/craft/trade . . . . . 18.0% *Foreman/supervisor* . . . . . 4.5% Middle management/Technical/ semi professional . . . . . 6.6% Professional and upper management 2.9%	Unskilled clerical/sales/service/manual labour . . . . . 22.0% Semi Skilled clerical/sales/service/craft/trade . . . . . 31.0% Skilled clerical/sales/service/craft/trade . . . . . 21.0% Foreman/supervisor . . . . . 3.9% Middle management/Technical/ semi professional . . . . . 17.6% Professional and upper management 4.3%
Employment status	Employed full time . . . . . 56.4% Employed part time . . . . . 4.6% Not employed 39.0%*	Not measured in 1994 study but 1996 Industry Canada data reveals that 30.4% of bankrupts gave unemployment as a reason for insolvency, the highest rating of all five different reasons for insolvency (see below in this table)
How bankrupt became aware of program	Lawyer or legal aid . . . . . 25% Another type of counsellor . . . . . 24% Friend or relative . . . . . 17% Credit counsellor/OPD . . . . . 15% Others . . . . . 19% includes: private trustee, own initiative, advertising, bank manager, family service bureaux (Quebec) or employer (in descending order)	Not measured in 1994 study

Socio-demographic variables	Brighton and Connidis, 1982 (data collected in 1977)	National Working Group Survey (data collected in 1994)
Reasons given for insolvency	Consumer debt . . . . . 49.2% Unemployment . . . . . 15.2% Health/misfortune . . . . . 14.3% Business related . . . . . 14.3% Marital/family problems . . . . . 6.8% does not total 100 due to multiple responses	Not measured in 1994 study but subsequent Industry Canada Office of Superintendent of Bankruptcy (1996) data reveals: Consumer debt . . . . . 43.6% Unemployment . . . . . 30.4% Health/misfortune . . . . . 7.1% Business related . . . . . 0.0% Marital problems . . . . . 5.4% does not total 100 due to multiple responses

* A much higher proportion of low income FITA filers were unemployed (58%) than were those in bankruptcy with private trustees (27%). Part-time employment for these two types of bankrupts was identical (4.5%).

$24,000 but he has only $2,400 in assets, mostly in the form of income tax and cash on hand. The difference between what he owes and what he can realize in assets is still about $20,000 and most of the debts are unsecured.

A deeper analysis of the findings reveals, however, that there are some very interesting trends occurring in relation to bankruptcy demographics. If these trends continue, Canada may be facing a gradual revision of the profile of Canadian bankrupts in years to come. These trends, which often include the complete reversal of previous findings or substantial redistribution of weights within specific variables, will now be examined using conventional socio-economic variables to organize the discussion. Explanations for many of the trends are outlined in an attempt to place the trends in the larger Canadian context. This discussion is followed by a summary and implications of the findings for research, policy and practice.

Age

The average bankrupt is five years older than 17 years previously, increasing from 33 to 38. Most telling is an examination of where this shift in age has occurred. The 1977 data revealed that 39.2% were quite young, aged 20–29, while those aged 40–49 represented only 14.3% of all bankrupts. By 1994, this seems to have completely reversed. Only 21% are aged 20–29 while the 40–49 age group has almost doubled to 26.9%. Furthermore, while bankrupts in 1977 did not tend to be over 50 (7.7%), people in this age group declaring bankruptcy has also doubled to 14.4%. Interestingly, there has been little change in the number of insolvent people aged 30–39 who declare bankruptcy, still 38%.

Bankruptcy in the over-40 age group may be an alarming trend since there will be 142% more seniors between now and 2030. These people will face more and more financial challenges given the threat to the Canadian government pension plan and old age security programs which are themselves going bankrupt (Turner, 1995). The trend toward older bankrupts cannot be ignored since the number of insolvent people over the age of 40 doubled in the 17 years (from 7.7% to 14.4%). The proportion of workers aged 45 and over is currently 28% of the Canadian labour force and is increasing rapidly as baby boomers age. This proportion will rise to 32% in the year 2000 and continue to rise to 39% by 2010. As people move into their mid-fifties, their labour force participation rate traditionally starts to decline marginally by about 10% (HRDC, 1994). This general trend for reduced labour force participation, combined with the trend of more insolvent people aged 40–49, does not bode well for the economic security of this age group, one of the largest age cohorts in Canada (Foot, 1996). Indeed, "the movement of the baby boomers through the age structure has been partially responsible for the increase in [Canadian] personal bankruptcy volumes" (MEPA/MEA, 1996, p. M5).

Furthermore, 41% of bankrupts who were over the age of 40 are part of the segment of Canada's population called the *sandwich generation*, those challenged by the necessity of balancing home, work and caregiving to dependents (McGregor, 1996). Midlife working couples will likely have to assume the role of providing future retirement resources for themselves while providing financial support for themselves, their household, their children and their own parents (Junk, Stenberg and Anderson, 1993). If they happen

Table 2
Comparison of financial characteristics of Canadian bankrupts in 1977 and 1994

Financial characteristics	Brighton and Connidis, 1982 (data collected in 1977)	National Working Group (data collected in 1994)
Annual Income	Individual Gross . . . . . $11,418.00 Individual Net $7,386.00	Individual Gross . . . . . not measured Individual Net $13,068.00
	Family Net . . . . . not measured	Family Net $17,623.00
Liabilities	$25,493.00 average	$24,300.00 average
Assets	$6,243.00 average	$2,400.00 average
Kinds of assets	*Income Tax* . . . . . 33.2% Cash (on hand or in bank) . . . . . 25.8% Money given to trustee as retainer or guarantee . . . . . 20.7% Selling furniture etc. . . . . 9.9% Selling vehicles/house . . . . . 7.7% Other (salary, legal action) 3.1%	*not measured in 1994 study*
Average number of and value of assets realized	Average # realized . . . . . 1.7 Average value of assets $964.00*	not measured in 1994 study
Deficiency	- $19,250.00 average	- $21,900.00 average
Types of debts	Financial institutions: -finance/acceptance co . . . . . 74% - chartered banks . . . . . 61% -credit union . . . . . 21% -trust company . . . . . 6% Credit Cards -bank cards . . . . . 30% -department stores . . . . . 46% -other retailers . . . . . 41% Government agency . . . . . 33% Utilities . . . . . 33% Others (gas cards, collection agencies) . . . . . 17% Private individuals . . . . . 33% does not total 100 due to multiple responses	Financial institutions . . . . . 83% Credit Cards . . . . . 79% Government agency . . . . . 67% Others (utilities) . . . . . 41% Private individuals . . . . . 32% does not total 100 due to multiple responses
Security of debt	Unsecured . . . . . 88.0% Fully or partially secured . . . . . 4.1% Preferred creditor . . . . . 5.9% Other 0.7%	Not measured in 1994 study but high incidence of private loans, credit cards and utilities infers unsecured
Value of assets by region	Atlantic Canada . . . . . $1,642 Quebec . . . . . $6,775 Ontario . . . . . $5,112 Prairies . . . . . $5,897 Pacific $13,309	Atlantic Canada . . . . . $2,500 Quebec . . . . . $1,250 Ontario . . . . . $2,720 Prairies . . . . . $4,500 Pacific $1,800

Financial characteristics	Brighton and Connidis, 1982 (data collected in 1977)		National Working Group (data collected in 1994)	
Value of liabilities by region	Atlantic Canada	$17,764	Atlantic Canada	$21,065
	Quebec	$25,327	Quebec	$22,564
	Ontario	$24,050	Ontario	$33,612
	Prairies	$23,813	Prairies	$19,620
	Pacific	$38,532	Pacific	$19,810

* Fully two-thirds of the FITA files (68%) yielded less than $250.00, which reflects the reality that filers were low income and qualified for the special bankruptcy program due to no assets. Only 1% of all files yielded more than $5,000 worth of assets even though the average liability was $25,493.

to become bankrupt, they face serious future repercussions since any retirement plans would have to be liquidated under a bankruptcy (but not under a proposal). Their present-day concerns cannot be minimized either, since loss of assets and a restricted lifestyle while paying off debts may seriously compromise caregiving abilities, especially if they lose their home in the bankruptcy process. This is no small concern given that a 1992 study determined that 75% of working people in Canada had caregiving responsibilities (Lero and Johnson, 1994). More cause for concern is that 60% of this care is given by women and there is a growing trend for more women to declare bankruptcy (39%, up from 27% in 1977).

The number of people between the ages of 55 and 64 who are bankrupt also doubled in the 17 years. Foot (1996) refers to this age group as the Depression Babies and characterizes them as holding senior jobs in government, business, and major educational and other institutions. They had their choice of jobs, ready promotions and steady employment, earning enough on one salary to support a house full of children. In general, the number of Canadians in this age group who left the labour force jumped 144% between 1983 and 1993 (HRDC, 1994). They were opting for early retirement packages and some were victims of downsizing. Nearly two-thirds of Canadians retire before the mandatory age of 65, on average, at the age of 62. This trend means there is an increasing gap between the age at which these people can draw government pension plans and the time when they leave paid employment, unless they successfully manage private investment portfolios, a practice which is not common for Canadians. Turner (1995) confirms that only one-quarter of Canadians have invested over $50,000. This gap creates a time of great vulnerability to excessive credit and debt (Schellenberg, 1994). Indeed, bankrupts over the age of 65 tend to become insolvent because they do not successfully make the lifestyle adjustment to a lower standard of living in accordance with reduced earning power; they resort to credit instead (John Just, debt counsellor, personal communication, Spring 1996).

Gender

A second trend is the apparent increase in the number of women declaring bankruptcy and even the numbers in Table 1 may not adequately reflect this increase. In 1977, data on gender was blurred because people in Quebec could declare joint bankruptcies, meaning gender was not noted in the file. Again, in 1994, Forde and Roberts note that the finding that more men declare bankruptcy than women may be biased somewhat because the male as head of household was more often reported on the fact sheets when a joint bankruptcy was filed. Despite this ambiguity, there has been an increase in the number of women declaring bankruptcy, up from 27% to almost 40%.

Marital Status

The increase in the proportion of women declaring bankruptcy may be related to a change in marital status. In 1977, nearly two-thirds of bankrupts were married (64%) while this had declined to 42.7% in 1994. At the same time, those who were divorced or separated made up 27.8% of bankrupts in 1994 up from only 19% in 1977. Most of this increase can be attributed to the increase in the number of divorced women declaring bankruptcy, which more than doubled in 17 years (from 6% to 13.5%). The proportion becoming separated virtually stayed the same (13%). Another very interesting development, which probably goes a long way toward explaining the decrease in number of married bankrupts, is the corresponding incidence of common-law couples declaring bankruptcy (21.1%). Perhaps it is serendipitous, but the decrease in bankrupts who were married is 21.3%,

virtually the same proportion of common-law people who declared bankruptcy in 1994. The proportion of widows hardly changed at all while the proportion of single people decreased slightly from 10% to 6.8%.

The numbers of divorced and separated persons who declare consumer bankruptcy (27.8%) is much higher than would be expected based on their percentage of the Canadian population (6% in the 1991 government census and 11% in the 1994 Angus Reid *Group State of the Family Survey*). The same observation holds for common-law relationships with approximately 10% of Canadians in this type of familial arrangement versus 21.1% of bankrupts, double the rate. Divorced and separated bankrupts face many financial challenges, especially meeting and supporting the needs of two (or more) separate families and households, supporting custodial children in the face of non-payment of maintenance and child support, paying legal bills, and paying off debts of the other spouse, often on one, low or no income (Clare, 1990; Klotz, 1994; Poduska, 1993; Williams, 1991).

There is a marked trend for more bankrupts to be divorced (doubled in 17 years). Indeed, there is a Canadian trend for more and more people to get divorced, meaning that more and more people will likely be experiencing this financial scenario. In Canada, 28% of marriages ended in divorce in 1994, up from 6.4% in 1921 (Vanier Institute of the Family, 1994). Interestingly, in 1985, about midway between the time span of these two studies, the divorce law in Canada changed, making it much easier to get a divorce. After one year of separation, one can get divorced in Canada (Baker, 1996). This legislative change could be reflected in the increased number of divorced bankrupts and the constant number of separated bankrupts. Figure 1 provides compelling evidence of a corresponding increase in the number of bankruptcies. Indeed, Clare (1990) and Klotz (1994) note that Canadian bankruptcies involving marriage breakdown have become very common.

Dependents

It was somewhat difficult to compare the number of dependents since this variable was measured differently, reflecting the age of dependents in the 1994 study while the number of dependents was reported in 1977. Nonetheless, the trend seems to be towards an increased number of bankrupts who do not have dependents (up from 38% to 57% in 1994). Over three-quarters do not have children over the age of 16 living at home in 1994. If they do have dependents, there is a trend towards having fewer dependents. For example, in 1977, 16% of bankrupts had 4 or more children while this number had declined significantly to only 2% in 1994. In contrast, 19% have just one dependent younger than 15 living at home, up from only 11% in 1977, almost double the previous rate. As well, fewer bankrupts now have 2–3 children (23%) than they did in 1977 (down from 34%). This is another variable which exhibits the pattern of reversed trends. Whereas 38% did not have children in the 1982 study, close to the same number (43%) do have children now. Or conversely, 62% had children in the 1982 study while almost the same amount (57%) do not have children now (see Table 1).

There is a trend towards more bankrupts having no dependent children (57% in 1994), or almost two-thirds. This figure is much higher than the Canadian average of one-third of Canadians with no dependent children. Furthermore, the Vanier Institute of the Family (1994) continues to suggest that this general trend is occurring because women are delaying childbirth due to the expense of raising children, to further their careers or because they have to work in order to make ends meet (dual income earners). So, they choose not to have children during this time of transition. Some couples consciously choose to have a smaller family in order to maintain a certain standard of living in a time of decreasing real income and the rising cost of living. While the average number of children per Canadian family is 1.8, the average number of dependents younger than 15, was even lower for bankrupts at 0.8. There is also a trend in Canada for voluntary childlessness and involuntary childlessness due to infertility, both of which contribute to fewer dependents, whether one is bankrupt or not. About one-third of Canadian families have no children at home, either due to the empty nest (they have grown up and left, 59%) or childlessness (41%). Absence of children implies fewer expenses and more flexibility with limited incomes, so one has to wonder why bankrupts tend to have fewer children save that it is a reality that fewer Canadians are being born in general.

An interesting Canadian trend, which might be of significance to bankrupts, is that of "boomerang" children remaining in the family home longer and/or returning to the home after experiencing life crises of

their own (Boyd and Pryor, 1989; The Vanier Institute of the Family, 1994). This situation results in changes in living arrangements and household composition and, perhaps, increased debt load due to an extra person to feed, clothe, shelter and nurture, especially if the adult child is unable to get employment. About one-quarter (23%) of bankrupts had children over the age of 16 still living at home. Since the 1977 study did not capture dependents by their age, it is not known if boomerang children is a trend for bankrupts but it bears monitoring considering the trend in the Canadian population.

Occupation

A very interesting realignment occurred in the category of occupational status. Whereas the majority of bankrupts in 1977 were employed in unskilled labour (38%), this type of employment has declined to only 22% in 1994, almost by half. At the same time, the number of bankrupts employed in middle management and semi-professional jobs more than doubled from 9.5% in 1977 to 21.9% in 1994. The biggest shift in this combined category occurred in the middle management/technical and semi-professional category, almost tripling from 6.6% to 17.6%. Otherwise, the proportion of bankrupts employed in semi-skilled, skilled and foreman/supervisor positions remained nearly constant (see Table 1).

In both studies, bankrupts tended to be clustered in low-paying semi-skilled and unskilled jobs (collectively, 53% in 1994). Their lower incomes could be explained by Morissette's (1997) finding that the percentage of employees working 35–40 hours per week in their main job continues to drop in Canada. In general, most Canadians (61%) work an average of 35–40 hours per week, down from 71% in 1977 (HRDC, 1994). Morissette notes that this drop in numbers of hours worked per week (meaning less earnings) cannot be explained by reduction in minimum wage or decline in the size of firms hiring. He suggests that a redistribution of employment by industry and union status explains 30% of the trend with other contributing factors: skill-based technological changes, rising fixed costs of labour, growth of irregular work shifts, competitive pressures and more free trade (also supported by HRDC research).

Whatever the forces behind the drop in the number of hours which people are able to work in order to earn income, this drop in earnings most assuredly will impact the ability of Canadians to meet payments regularly, leading to potential insolvency and possible bankruptcy or consumer proposals. HRDC confirms that "fewer people have the luxury of a stable nine-to-five job, Monday-to-Friday with evenings and weekends at home... . A quarter of the work force are on rotating or irregular shifts" (p.16). This situation strongly implies that income will be lower and more irregular, further challenging Canadians as they strive to live on uncertain incomes, probably resorting to credit to meet the peaks and valleys of sporadic earnings. Excessive credit was the main reason given for insolvency both in 1977 and 1994 (see Table 1).

What is telling, as far as labour force participation and occupation is concerned, is the increase in the number of bankrupts employed in middle management and semi-professional positions, more than doubling from 9.5% in 1977 to 21.9% in 1994. One plausible explanation for this is the pervasive trend towards downsizing of firms in Canada, entailing cutting out the middle layer of management. Downsizing can take the form of: (a) across the board cuts, (b) early retirement and voluntary turnover, (c) delayering or removal of middle management, (d) contracting out specialized functions, and (e) dropping product lines and programs (Evans, Gunz and Jalland, 1996). The average time it takes for someone in this situation to find employment again is about six months (Cornell, 1997).

Education

Educational level was not measured in 1977 but Brighton and Connidis (1982) cite several studies conducted in the late 1970s which examined indebted, not bankrupt, consumers and they invariably had only a high school education or less (Puckett, 1978; Treblicock and Schulman, 1976). Reporting on Canadian bankrupt data collected within the Superintendent of Bankruptcy's office in the mid 1980s, Clare (1990) notes that "many bankrupts do not read or write. A large number left elementary or high school early" (p. 204). This finding was corroborated by the 1994 study which revealed that the majority of bankrupts have less than a high school education (57.5%).

Given that approximately 80% of bankrupts in 1994 had a technical school and/or high school education or less (see Table 1), the finding that three-quarters of bankrupts are employed in skilled, semi-skilled or

unskilled labour should not be surprising. "High levels of educational attainment have consistently been associated with well-paying, high status occupations" (Butlin and Oderkirk, 1996, p. 6) and the reverse is true. Bankrupts seem to come from the segment of the Canadian population that drops out of school early, leading to written, numeric and computer illiteracy. Clare (1990) ponders the soundness of the expectation that consumers have adequate proficiency in the marketplace to understand credit and contract terms or to adequately function in a workplace grounded more and more in written information and computer systems. Low levels of education hold consumers back financially at a time when Canada is shifting to an information-based economy. As a fall-back, bankrupts tend to cluster in the service-based industry positions as reflected consistently across the years (see Table 1).

Employment Status

The 1982 study captured employment status in 1977 with two-thirds of bankrupts employed full-time (56.4%) or part-time (4.6%). Although employment status at the time of filing bankruptcy was not measured in the 1994 study, recent 1996 Industry Canada data on bankrupts reveals that 30.4% of bankrupts gave unemployment as a reason for insolvency, the highest rating of all the different reasons for insolvency (see Table 1). Although fewer people claimed to be unemployed in 1996 (30.4%) than in 1977 (39%), the number of people citing unemployment as the reason for their insolvency doubled, up from 15.2% in 1977 to over 30% in 1996. In comparison, those citing consumer debt as the main reason for insolvency decreased slightly from 49.2% in 1977 to 43.6% in 1996. Also, those citing health reasons and personal misfortune declined by half, down from 14.3% in 1977 to only 7.1% in 1996. A major difference in reasons cited for becoming insolvent is the total absence of those claiming to have a failed business in 1996, compared to 14.3% in 1977.

To complicate matters, many Canadians are now working in part-time jobs and, often, in several jobs. In 1977, only 4.6% of bankrupts were employed in part-time work (Brighton and Connidis, 1982). Canada is now "seeing a huge increase in part-timers in virtually all sectors of the economy. According to Statistics Canada, 21% of Canadians are part-time or temporary. And that number is growing" (Thomas, 1996, p. 45). This trend is likely impacting insolvent Canadians seeking bankruptcy and consumer proposals, although the results from the 1994 study do not provide data which can corroborate this proposition. Kidd (1996) does clarify that, in Canada, after the deep 1990 recession, only one-quarter of a million jobs were created, with almost all of them part-time, temporary or contract work. Figure 1 vividly profiles the corresponding increase in the number of bankruptcies after the 1990 recession (MEPA/MEA, 1996). The working force of Canada now is rapidly moving towards part-time status, a situation which has the potential to severely compromise the economic security of many Canadian households, possibly leading to insolvency.

Industry Canada (1996) reports that the average Canadian bankrupt is between jobs for an average of one year or longer, complicated further by increased job turnovers and resultant interruptions in earnings. On the other hand, the average time span for Canadians, in general, to be between jobs is only 18 weeks, albeit this is up from 15 weeks in 1980 (Cohen, 1991). The ongoing trend in downsizing means that more and more people will experience a major disruption in income at the peak of their earning years. The corresponding upward trend in lag time between job loss and new employment implies that everyone can anticipate waiting longer to get a job, exposing them to the risk of insolvency and potential bankruptcy.

Indeed, more and more bankrupts are citing unemployment as a reason for their insolvency, doubling over the 17-year period. There is a general trend in Canada for rising unemployment, up from 5% in the mid seventies to over 10% in the eighties and nineties (HRDC, 1994; Kidd, 1996; Toulin, 1995). Interestingly, as the unemployment rate doubled, so did the incidence of people declaring unemployment as the reason for their insolvency (15% in 1977 versus 30% in 1996) (Industry Canada, 1996). The Industry Canada data show that some 75% of Canadian bankrupts experienced job turnover or interruption within three years prior to declaring bankruptcy. These job turnovers and earnings interruptions force individuals to deplete their savings and amass debt.

Regional differences for unemployment are present but do not explain the variation in levels of assets and liabilities for bankrupts in Canada. This supposition

has not yet been tested statistically, so the following points are speculative at best. Consider that Alberta now has a strong economy but has the highest levels of consumer debt, next to Ontario which has a struggling, restructuring economy. The Atlantic region has historically experienced higher unemployment than the rest of Canada, yet bankrupts in this region do not carry debt loads inordinately higher than in other regions. In fact, "the trend over the past 20 years indicates this rising consumer bankruptcy rate occurs regardless of the economic climate" (Toulin, 1995, p. 3).

Income

The annual net income earned by a bankrupt person in 1994 was almost double that earned in 1977, or $13,068, up from $7,386. Much of this change results from inflation in the 1970s and 1980s. The 1994 survey did not ask for gross income but it did ask for family income, hoping to capture dual income earners, who make up over 60% of the Canadian population (Lero and Johnson, 1994). Average net family income was $17,623 in 1994. The range was $0–49,000. It is difficult to compare gross income across the years since the data collection method was not the same. However, the earnings of bankrupts are much lower than the Canadian average. In 1994, an average Canadian family earned $57,696 and paid out $27,203 in taxes leaving a net family income of approximately $30,493 take home (Turner, 1995). This is far more than for bankrupts who took home only $17,623. Indeed, income for Canadians has been stalled for twenty years. Between 1951 and 1971, pre-tax income doubled to $50,000 for only one earner. But, between 1974 and 1994, pre-tax income rose only 17%, increasing only $4,000 up to $54,000 and that is for two earners (Kidd, 1996).

Exacerbating this situation, over 60% of Canadians live in dual income families and the numbers are growing (The Vanier Institute of the Family, 1994). This means that Canadians are now more likely to live in a home where both parents, spouses or partners are working, paying for the costs of extra clothing, transportation (and possibly child care) for the second job, yet taking home less and less since real income is stagnant. This spells real trouble for the state of solvency and economic security of almost two-thirds of Canadian families. We do not know if bankrupts live in dual earner families but the $4,555 difference between net family income and net personal income in 1994 seems to suggest they do. The data on income may not truly reflect family earnings since, often, when a joint filing is made, incomes from both spouses are combined and entered as one figure. Nonetheless, the Canadian trend towards dual income earners is likely to spill over to bankrupts as well, given that such a large proportion of people live in this type of household.

Assets and Liabilities

On the surface, there appears to be very little difference between the findings of the two studies regarding level of liabilities owed by bankrupts. In fact, there is a decrease in liabilities, down from $25,493 in 1977 to $24,300. However, there is marked change in the level of assets to which bankrupts have access for resolving their debt load. In 1977, bankrupts listed assets worth $6,243 on average, but this declined to only $2,400 in 1994, almost $4,000 less. This corresponds to a larger deficiency between bills owing and money available to pay them off, -$21,900 in 1994 compared to -$19,250 in 1977. The median level of assets of consumer bankrupts in Canada was only $2,400. This value ranged from zero to $2.2 million. In general, almost 40% of Canadians do not have even $10,000 in assets. Almost three-quarters (70%) of Canadians have saved or invested less than $50,000 (Turner, 1995). This means that insolvent bankrupts are even worse off than the inadequately prepared *solvent* Canadian. The median value of consumer liabilities, on the other hand, was $24,300 (a ratio of 1 to 10). Liability levels in 1994 ranged from $377 to $5.2 million.

The plight of bankrupt persons matches a trend in Canada. The total mortgage debt and consumer debt, as a percentage of disposable income, is growing exponentially. In fact, mortgage, consumer loans and credit card bills now consume 92% of after-tax income in Canada, compared with only 25% (Kidd, 1996; MEPA/MEA, 1996; Turner, 1995) when the 1977 data were collected by Brighton and Connidis (1982). Stalled and decreasing consumer income strongly suggests that we can expect more insolvent Canadians, especially when this finding is coupled with the phenomenal increase in the use of credit in Canada. Just as an example, in 1994, there were an estimated 58 million credit cards in circulation in Canada, including 28 million bank cards, up from 14 million bank cards in 1985. In 1979, Canadians held $2.4 billion in debt on Visa and Master Card (bank

cards), a figure which has escalated over 600% to $15.4 billion in 1994 (Pirisi, 1995). Credit limits have doubled or tripled over the past decade (Lorinc, 1996), meaning people have easier access to even more debt.

Brighton and Connidis (1982) determined that trustees were able to realize only 1.7 assets per bankrupt, most likely to be income tax returns and cash on hand (collectively, 59%) or a retainer for the trustee (20.7%), followed by selling furniture, vehicles and homes (totalling 17.6%) (see Table 2). When these assets were realized (through calculated income tax returns, seizure of bank accounts, foreclosure on homes, sale of household goods and vehicles), the average amount garnered from these liquidations was only $964. This yield occurred despite the reality that the bankrupt held on average $25,493 in liabilities. Also of interest, two-thirds of the FITA bankrupts were only able to realize $250 or less, a small cry from the average $25,493 outstanding in debts. Data on realization of assets from bankrupts was not captured in the 1994 study. Debtors in a consumer proposal do not lose their assets so there is no data to collect.

A major change in types of liabilities during the 17 years is the proportion of debts owed by bankrupts to government agencies, doubling from 33% to 67% in 1994. One possible explanation for this trend is the marked higher incidence of student loans, since only 1% of government debts in 1977 were student loans (Brighton and Connidis, 1982). Conversely, defaulted student loans are such a problem in the nineties (Yeadon, 1997) that recent changes to the BIA disallow an application for bankruptcy due to student loan default for ten years after graduating. Clare (1990) provides some clarification on why some students default on their student loans, including an inability to find work and establish an income level sufficient for repaying their loans. Another suggestion is that mature students give up full-time jobs to return to school. They then incur debts to support their families and/or studies, failing to realize how quickly they can fall behind financially.

The reader is reminded that both studies made a concerted effort to capture regional differences when the sampling frame was designed. Although limited space will be allotted to comments on regional variation, marked differences along the lines of assets and liabilities between the five regions merit some discussion.

The most striking change from 1977 to 1994 is the phenomenal decrease in the value of assets in the Pacific region, down from $13,309 to only $1,800. Just as striking is a reversal in the amount of money owed, down from $38,532 to only $19,810. The ratio of asset to liability decreased from 2:1 to only 10:1. The other regions did not exhibit such dramatic changes in asset to liability ratio. Quebec and Ontario did have a marked decrease in levels of assets but not as dramatic a change in liabilities as the Pacific region, although Ontario residents did experience an average increase of $9,562 in liabilities, much higher than the national average of $2,400. In contrast, bankrupts living in the Atlantic region showed an increase in the level of assets ($2,500 up from $1,642) although they owed marginally more than they did in 1977 (an additional $3,300).

Much of the variation in assets and liabilities among regions can be explained, on the surface, by changes in regional economies. Western provinces experienced an economic development boom after the 1986 World Fair leading to higher employment and increased consumer confidence and buying power. There has also been a large influx of foreign monies into British Columbia, strengthening the regional economy (Toulin, 1995). In contrast, Ontario and Quebec's economies were hard hit by the North American Free Trade Agreement (NAFTA) leading to massive plant closures and the decline of many one-industry towns manufacturing cars, furniture, leather goods, shoes and textiles. This involved a huge loss of semi-skilled and unskilled labour as well as those employed in middle management (reflected in Table 1). These regions experienced the most dramatic changes in assets and debts owing over the 17 years (see Table 2).

Security of Debts

The bankrupt person tended to hold predominantly unsecured debts (88%) in 1977. The high incidence of private loans (32%), credit cards (79%) and utilities (41%) in 1994 implies an equally high predominance of unsecured loans (see Table 2). It is difficult to compare the types of debts directly since the data were collected differently, but the trend still seems to be financial institutions, credit cards, utilities and private individuals. A major change was in the proportion of debts owed to government agencies, doubling from 33% in 1977 to 67% in 1994. Another interesting

trend is the increased numbers of bankrupts who are defaulting on utilities (telephone, power, cable, fuel), up from 33% to 41% in 1994.

SUMMARY

This paper profiled and compared the first two national studies of Canadian bankrupts, one reported by Brighton and Connidis (1982) using 1977 data and the second reported by the 1994 National Working Group.[2] Except for some intriguing variations in demographic variables, the stereotypical profile of Canadian bankrupts has not really changed in 17 years. A deeper analysis provides compelling insights, however, into future trends related to the socio-demographic profile of Canadian bankrupts. If these trends continue, Canada may be facing a gradual revision of the profile of bankrupts in years to come. These trends often include complete reversal of previous findings or substantial redistribution of weights within specific variables, specifically of age, gender, marital status, dependents, occupation and employment status.

Future profiles of bankrupts may reflect a person over the age of 40, working in middle and upper management; in a dual income family, divorced or living common law; more often a female with elderly dependents or with custodial children. The person may still have a relatively low level of education but may also be a better educated person holding down an unskilled occupation due to downsizing, job loss and increased jobs in the service economy. Such persons will have experienced a lag time between losing a lifetime career and finding, then losing, several part-time, temporary or contract jobs. If over the age of 60, they may have been facing the gap between early retirement or being downsized, having to resort to unsecured credit to make ends meet and bridge the gap. This profile is quite different from the long-standing stereotype of a 35-year-old blue collar married male with children, earning a low income in a semi-skilled or unskilled job due to lack of high school education and money management skills.

Many changes seemed to have happened over the last 17 years. The analysis further suggested that these changes could be attributed to a reconfiguration of Canada's demographics, economic policies, labour policies, lending policies and wider acceptance and usage of credit. Each will be summarized.

Demographically, Canada is experiencing a low fertility rate, and later marriages or common-law arrangements in lieu of marriage. Divorces are on the increase as are dual income families. There are new phenomena such as the sandwich generation and boomerang kids. Major age cohorts, including the baby boomers and the Depression children, make up the Canadian population, causing massive changes due to their sheer numbers.

The economy is restructuring, shifting from a domestic economy grounded in agriculture and manufacturing to a global economy replete with free trade zones, service industries and an information-based, technological economy. To accommodate this shift, labour is changing so that people no longer have access to the typical 9 to 5, 40-hour-a-week job. Instead, they are working in non-standard jobs in irregular shifts, often for less than 35 hours per week and in multiple part-time, temporary and contract positions. Many people are starting their own companies to offset the declining number of middle management positions being cut due to downsizing. People face more and longer terms of unemployment.

To meet the serious needs of people living in such an economy and labour market, who do not want to lower their standard of living, creditors are finding new and creative ways to loan money, with the standards continuing to be credit cards, consumer loans and utilities. Consumers are amassing huge personal debts with these sources and still turn to families and

2 In early spring of 1997, Industry Canada awarded a tender to Schwartz and Anderson (1998) for another project on consumer bankruptcies. Industry Canada titled this project "*Personal bankruptcy study: Assessing the consumer issues specific to personal insolvency by better understanding the causes of insolvency*". A future analysis will compare their demographic results with the findings shared in this paper. Schwartz and Anderson added several new demographic variables including immigration, employment status and receipt of government transfers. They make frequent mention of Brighton and Connidis' 1982 study but little mention of the 1994 Working Group work.

friends for loans as well as lines of credit and alternative financial services (cheque-cashing services, money orders, income tax rebates, etc.). Most of this credit is unsecured; if the debtor defaults, the lender has little recourse but to resort to invasive and pervasive collection agencies and legal action. Harassment over indebtedness, stress and economic insecurity turn people to legal options to resolve their insolvent state — bankruptcy, consumer proposals and OPD.

RECOMMENDATIONS

This exploratory analysis reveals that the profile of bankrupts is changing and many factors are responsible for these changes. Awareness of these continuing changes is crucial if policy makers and service providers wish to meet the needs of insolvent Canadians as they struggle to gain economic security and independence. Many people have to assume responsibility for this state of affairs. Consumers need to become educated, and more responsible, about their use of credit and living within their means. Consumer education needs to become an integral part of the public education system so that citizens are socialized into the role of responsible buyership, decision making and resource management. Credit grantors must bear more responsibility when lending money to people, better ensuring that they are able to assume more debt given their current financial picture and future prospects.

Government agencies must become cognizant of the unintended impact of their policies on citizens. Who would have recognized that changing the *Divorce Act* or making bankruptcy more accessible (in 1978) would have what seems to be such a profound and long-term negative effect on the rate of bankruptcies in Canada? Labour policies are changing to accommodate the restructuring of the Canadian economy to enhance global performance and competition. Closer attention needs to be paid to the impact on the economic security of millions of families of downsizing and of the creation of part-time, temporary and contract work in the service and information economies and other sectors. Finally, social policy regulating poverty, employment, pensions and income, and wealth distribution needs to consider the link revealed in this analysis between low income, unemployment and aging, and the predisposition to become insolvent.

CONCLUSION

Policy makers and other stakeholders can use the information generated in these two inaugural studies, and the subsequent analysis, to improve conditions leading to less incidence of insolvency. Since these recommendations so closely parallel those shared by Brighton and Connidis (1982) 17 years ago, the imperative of economic security for Canadians precludes dismissal of the task of seriously considering the complex political, economic, social, technological and familial milieu in which Canadians strive to maintain a dignified standard of living. It would be irresponsible to let another 20 years pass without collectively dealing with this relentless rise in bankruptcies. One segment of society cannot do it alone. Witness the recent Industry Canada mandated insolvency counselling for bankrupts who want automatic, unconditional discharge (Forde and Roberts, 1994a,b; Industry Canada, 1994a,b; Liptrap, 1996; McGregor and Berry, 1997a,b). This important step does not seem to be sufficient to stem the rise in the number of insolvent Canadians, if the evidence in Figure 1 is any indication.

The findings from this analysis can shape future policy, research, practice and advocacy such that the alarming incidence of bankruptcy can be reversed and the economic security of Canadians better assured. For indeed, very few individuals begin their financial lives with the expectation that they will become insolvent (National Consumer Law Centre, 1992; Poduska, 1993; Williams, 1991); yet over 80,000 Canadians currently find themselves facing this reality each year. There must be a collective effort to redress this economic and personal inequity which persists in haunting both household and national economies. Recognizing the trends in shifts in bankrupts' demographic profiles is one step toward this collective agenda.

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