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Why are Personal Bankruptcies Rising?

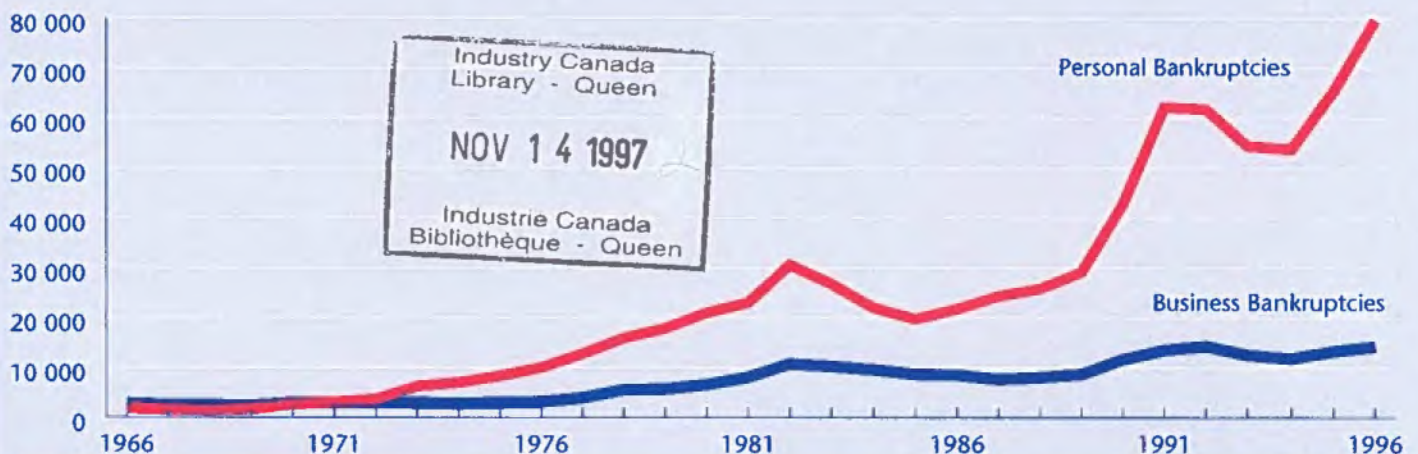
Personal bankruptcies are at record-high levels in Canada, reaching 79 631 in 1996, a 22% increase from 1995 (see Figure 1). This upward climb is puzzling because Canada is experiencing firm economic growth. Business bankruptcies, for their part, declined by 13% in the first seven months of this year, while the number of personal bankruptcies rose 12% in the same period.

To better understand this phenomenon, the Office of Consumer Affairs commissioned COMPAS Research and the Centre for Policy and Program Assessment at Carleton University to conduct a study on the causes of insolvency. The researchers polled 1 094 people in all regions of Canada who had approached a bankruptcy trustee during March and April 1997 about protection from their creditors. The last Canadian survey in this area was done 20 years ago, while the last major American study was

conducted in 1981. As well as covering new ground, the current study asked the same questions as its predecessors to identify changes over the last two decades.

This edition of the *Consumer Quarterly* looks at the initial results of the new survey, and addresses several issues: Who is going bankrupt? What triggered the insolvency? Did respondents have any other options? Have attitudes toward bankruptcy changed?

Figure 1
Personal Bankruptcies on the Rise



Source: Annual Statistical Summary of the Office of the Superintendent of Bankruptcy

Who is Going Bankrupt?

A possible explanation for the rising trend in personal bankruptcies is that over the last 20 years, women, students and self-employed Canadians have been able to accumulate and sustain debt and, consequently, are adding to the pool of potential debtors at risk. While there may be other groups requiring equal consideration, these three were identified to allow comparisons to previous research.

Women form a greater proportion of people in bankruptcy than ever before: 41% today compared to 25% two decades ago. It may be that the increased economic independence of women has contributed to this change in the pool of potential debtors. This is consistent with the greater participation of women in the labour force and the greater access to credit they have as a result. Another factor may be that there are more single-parent families, many headed by women, than there were 20 years ago.

Students now face larger debt loads than their predecessors. The dollar volume of federal and provincial student loans nearly tripled between 1990 and 1995. In addition, students often face unemployment, underemployment and volatile incomes after graduation, all of which affect their ability to pay down their loans. About 25% of survey respondents reported having student loans and 10% reported student-loan debt as a major event triggering their insolvency. In contrast, less than 1% of people facing bankruptcy 20 years ago had student loans.

Self-employed individuals and those involved with small businesses also form a large proportion of the Canadians who declare personal bankruptcy. Although 10% of the sample reported self-employment as their major source of income at the time of insolvency, almost 25% reported being self-employed in the past five years. The self-employed also had a median level of debt that was 2.5 times greater than that of other respondents (\$50 000 compared to \$20 000).

What Triggered the Insolvency?

A vast majority of respondents (85%) indicated that there were specific events or debts that triggered their insolvency. By far the largest factor, cited by 25% of respondents, was a decline in income due to the loss of a job. Student loans, marital disruption, credit-card debt, creditor "harassment" and the person's inability to repay loans (resulting from excessive debt service

payments) all figured prominently in the list of contributing factors (see Figure 2).

In addition to the immediate triggers for bankruptcy, respondents were also asked to rank important contributing factors. Heading the list were "not enough work" and "too much borrowing or credit-card use," which were seen as important by 53% and 50% of the respondents, respectively.

Figure 2
Events/Debts Triggering Insolvency



Source: COMPAS for Industry Canada, 1997

Did Respondents have any Alternative to Bankruptcy?

The survey results suggest that there was little choice for most respondents but to declare bankruptcy to remedy their financial situation.

Many of the respondents had experienced some financial instability or reduction in income as long as two years before filing for bankruptcy. Almost half of the respondents reported receiving either Employment Insurance or Social Assistance in the previous two years (see Figure 3). The fact that respondents received income from these sources indicates that their income was low or had changed significantly.

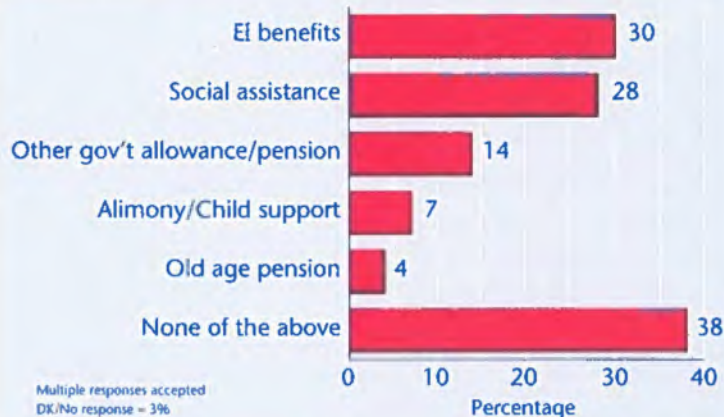
In addition to demonstrating that they were eligible for assistance from various government programs, many respondents also failed a key market test. Two thirds of respondents reported applying for credit in the two years prior to bankruptcy. Of those, a full 63% were turned down by would-be creditors. Given the individual's expected income and current debts, potential creditors had determined that these individuals could not sustain additional debt.

When it did become clear to respondents that they were, indeed, in serious financial difficulty, nearly all (93%) took various actions to try to avoid getting into worse trouble. Two thirds said they reduced their level of spending, one half renegotiated their debts with creditors and 44% consolidated their loans. Approximately one-in-five either took a second job or obtained professional credit counselling. Only 7% indicated that they took *no* action at all to avoid bankruptcy (see Figure 4).

A majority of the respondents (59%) also resorted to other measures to restructure their existing debts. Heading the list by a wide margin was the use of credit cards to pay down other debts (39%). Although this activity can be counterproductive (because of the high interest rates on some credit card balances), many seem to view it as a last-ditch effort to buy time until they can re-establish their income or sell an asset. A sizable proportion of respondents liquidated assets, by either cashing in an RRSP (17%) or selling their home (8%). Others used alternative financing arrangements to fund major assets, including leasing a car (13%) and purchasing something without a down payment (10%) (see Figure 5).

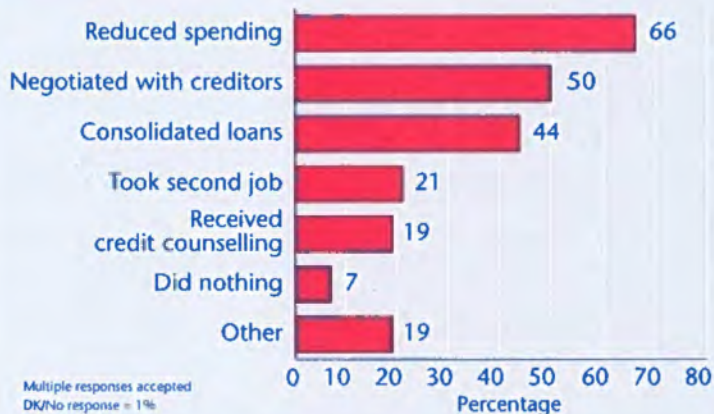
This evidence suggests that the only option left for many of the respondents to address their financial situation was to declare bankruptcy. Many of the respondents were in unsound financial positions as long as two years before bankruptcy. In addition, almost all made efforts to try and meet their financial obligations, even if those actions were not effective.

Figure 3
Selected Revenue Sources in Past Two Years



Source: COMPAS for Industry Canada, 1997

Figure 4
Efforts Made to Avoid Bankruptcy



Source: COMPAS for Industry Canada, 1997

Figure 5
Activities During Past Two Years



Source: COMPAS for Industry Canada, 1997

What are Current Attitudes Toward Bankruptcy?

The survey explored the perceptions people have of bankruptcy. In particular, respondents were asked to comment on the perceived impact of declaring bankruptcy.

- Almost half (46%) believed that bankruptcy is "more acceptable now than it was 10 years ago."
- Almost half (47%) saw bankruptcy as being "a financial decision like any other."
- The majority of respondents (57%) agreed with the statement, "Bankruptcy is a way to start over and to overcome past misfortunes."
- One quarter (26%) of the respondents thought that bankruptcy was a "sign of

personal failure," while 47% believed that "others look down on it."

Almost three quarters of respondents thought that declaring bankruptcy would have a large effect on their ability to borrow in the future. Only 17% were neutral on this point, while the remaining 8% thought that bankruptcy would not have a large effect. This suggests that people strongly believe that a negative mark will be placed on them by potential creditors following bankruptcy.

For several reasons, it is not possible to draw conclusions about whether changing attitudes could explain some of the increase in the number of personal bankruptcies. First, there is no benchmark against which to identify changes in

attitudes towards insolvency, let alone the affects of attitudes on the decision to file for bankruptcy. Second, there was no attempt in the survey to identify the motives of individuals faced with insolvency. Third, contingent factors, such as from whom the individual first heard about bankruptcy, could have a significant impact on an individual's attitude. For example, in this survey, 62% of respondents found out about bankruptcy as an option from "family" or "friends" — presumably people whose opinions the individual respected.

Based on the evidence so far, it is premature to come to any firm conclusions about whether attitudes affect a person's decision to declare bankruptcy.

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English
<http://strategis.ic.gc.ca/oca>

or French
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The Evidence So Far

The causes underlying the current rise in the number of personal bankruptcies require further investigation, but some observations can be drawn from the preliminary survey findings.

First, a portion of the large increase in consumer bankruptcies may be explained by a growing pool of certain kinds of debtors, namely women, students and self-employed Canadians. Greater debt loads among these groups are related to underlying changes in Canadian society and the economy. Many of these developments, greater access to credit in particular, are positive on balance. With them, however, comes an unfortunate consequence — a higher level of personal bankruptcies.

Second, most people who face bankruptcy experience a specific event or debt that triggers the insolvency. Most often, in this survey, that trigger is a decline in income due to the loss of a job. Student loans, marital disruption

and credit-card debt are also common factors.

Third, the vast majority of people surveyed did not have an alternative to bankruptcy. Nearly two thirds of respondents demonstrated that, prior to bankruptcy, they had experienced serious financial difficulties. And, regardless of the reasons for their troubles, more than 9 in 10 took concrete actions to try to avoid bankruptcy.

Fourth, the evidence for changing attitudes as a cause of rising bankruptcy rates is inconclusive. On the one hand, almost 50% of respondents believe that bankruptcy is "more acceptable now than it was 10 years ago." On the other, 47% believed that "others look down on it."

The detailed report on the survey will be released on the Office of Consumer Affairs Web site (<http://strategis.ic.gc.ca/oca>) early next year.