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Born again, financially

Is personal bankruptcy really an option?

Garry Marr, Financial Post

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If Canadians were to think of themselves as businesses, many would have negative cash flow.

Maybe they should be called born again. Thousands of Canadians have suffered a "financial death" during this economic downturn, but come back to rebuild their wealth.

New numbers from the Office of the Superintendent of Bankruptcy Canada this week paint a dismal picture. Consumer bankruptcies are up 54.3% from a year ago, with 106,933 Canadians filing over the previous 12 months. In June alone, 10,823 Canadians went bankrupt, a 9.3% jump from May.

Laurie Campbell, executive director of Credit Canada, sees the walking financial wounded come through her Toronto doors every day. This time, she says, bankruptcies are higher because Canadians have never been so ill-prepared for an economic downturn.

"We found out we were in a recession in November and bankruptcy numbers spiked in December. Generally there is a lag, but in this case that did not happen because the amount of debt Canadians are carrying is astronomical. "The first sign of economic downturn, people threw in the towel," says Ms. Campbell.

She says credit cards are the problem. Since their introduction in the 1960s, debt levels have increased to the point that the average Canadian has a debt level that is 131% of their income.

Statistics released this month from Equifax Canada back her up. The credit-rating agency's numbers show consumer credit delinquency to the end of June was up 24%

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from a year earlier. The average delinquency rate in Canada at the end of June was 1.56%. A delinquent account is defined as a credit facility that has not received a payment for 90 days.

If Canadians were to think of themselves as businesses, many would have negative cash flow. With negative cash flow, how long can a business stay afloat?

"They are spending more money than they are making, simply put. They are living beyond their means," says Ms. Campbell, who believes bankruptcy does represent an important option.

"But you do need to understand you have suffered a financial death and will be starting over."

The key is to learn from a bankruptcy. A cat may have nine lives but there are only so many times you can be financially reborn through bankruptcy or your credit rating will never recover.

And some people never learn. Andy Fisher, a trustee with A. Farber & Partners Inc., has seen clients that have declared bankruptcy four times. There are tales of people going beyond that.

He says the time to come in and talk to a trustee is before you get to the tipping point where bankruptcy is your only option. Usually your first visit to a trustee is free.

"We review your situation and for some people bankruptcy is not what they have to do," says Mr. Fisher, who says one sign of a problem is when you are struggling to make the minimum payment on your bills and are not paying down debt.

A trustee can lay out other options. He or she can help you work with your creditors to come up with a payment plan that will get you out of debt without any sort of insolvency filing. Creditors may negotiate better terms because it is preferable to bankruptcy where they get just a percentage of their money back.

Another option is something called a consumer proposal, which is a formal proceeding under the Bankruptcy Act. You get legal protection and you pay back a certain percentage of your debt.

"To do a consumer proposal, you need to have the cash flow to pay your creditors a certain amount each month," says Mr. Fisher, adding that usually means you're going to pay at least 15% to 20% of your debt over a five-year period. The rest of your debt is wiped out.

The difference between a consumer proposal and bankruptcy on a practical basis comes down to your credit rating. A bankruptcy stays on your record for seven years; a consumer proposal for three years.

"Some people have a strong feeling that they don't want to go bankrupt, they want to have something to pay toward their creditors," says Mr. Fisher.

Ultimately, bad credit is going to cost you in terms of higher interest rates, not to mention the ability to get a loan in the first place.

The solution to this dilemma is painful to hear. It involves saving.

Certified financial planner Ted Rechtshaffen advises clients to have enough cash on hand to deal with three to six months of no income.

That savings could be the difference between life and financial death.

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