AN EVALUATION OF THE SMALL DEBTORS PROGRAM IN MANITOBA

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This study inquires into the circumstances of discharged bankrupts a few years after their declaration of bankruptcy. The purposes of the study were, first, to determine the satisfaction or dissatisfaction with the Small Debtor Program, and second, to evaluate the socio-economic effect of bankruptcy on family life. The findings of this study will be helpful to those who counsel prospective credit users and families of over-extended individuals who are considering bankruptcy.

Consumer debt in Canada has skyrocketed from a comparatively modest $450 million following World War II to a staggering $33 billion in 1978. Today the average Canadian family of four owes at least $5,225 (excluding mortgage debt) to lending institutions, reflecting a dramatic change in attitude from borrowing as a last resort to borrowing against the future. Many borrowers are ignorant of the most basic principles of personal money management, despite their eager acceptance of credit as a way of life.

A number of complex, related factors has contributed to the increased use of credit, the higher rates of insolvency and the accelerated use of bankruptcy as a mechanism for release from debt. The number of personal bankruptcies in Canada during 1973-1978 has increased from 4,671 to 10,830 or 231 precent. Manitoba, the locus of this study, experienced an increase in personal bankruptcy from 206 in 1973 to 577 in 1978, or 280 percent.[1]

What are some of the factors that have led to the abuse of the credit system? First, many consumers do not know the costs of borrowing, nor does it appear to be an important consideration in consumer behavior. Most legislation on consumer borrowing is based on the principle of the borrower's ability to negotiate the cost of the loan and to choose the lending institution on the basis of available information. Legislative measures ensure that such information will be freely disclosed and, although lending institutions comply with the law, prospective borrowers evidently do not use such information to advantage. For example, in the extreme case of the bankrupts included in this study, 45 percent were unable to venture a guess as to the rate of interest of their loans, and of those who tried, 50 percent were wrong! Second, greed for the profits to be obtained from credit has led to the relaxation of credit granting standards. Frequently credit is extended to people who are unable to pay in an orderly fashion. There is some evidence that even the most imprudent debtors are able to get credit when they are heavily in debt. Merchants and lenders may actually encourage debtors to over-extend themselves by not investigating carefully the debt position and repayment capacity of prospective borrowers.[2] Third, there is little doubt that the "play now, pay later" attitude of consumers themselves has contributed to failure to distinguish between essential and frivolous credit buying.

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1. Consumer and Corporate Affairs, *Background Papers for the Bankruptcy and Insolvency Bill* (1978) 7.
2. D. Caplowitz, *Consumer in Trouble* (1974) 65.

Remedies are limited for individuals and families whose debts eventually build into a burden too crushing for them to bear. As stated earlier, personal bankruptcy is the remedy that is being adopted frequently. Canadian research on the topic is limited, however, and most existing studies deal with the analysis of the socio-economic characteristics of the bankrupts at the time of filing for bankruptcy.

The Small Debtor Program

One of the main objectives of *The Bankruptcy Act*[3] is to release the over-committed debtor from his debts to give him a fresh start. In the summer of 1972 the federal government started a program aimed at providing low income and lower middle income individuals with the assistance of a federal trustee if they could not afford a $500 to an $800 fee required by private trustees.

When the program was first introduced in Manitoba (February, 1973) there was an extensive set of criteria placed on entrance into the program. The intention was to serve the consumer debtor. The program stipulated that the debtor must:

— be a person, not a corporation.
— be insolvent and have debts of at least $1000.
— not be self-employed or have any business debts.
— not have income in excess of $3000 for a single person, $5000 for a married person and $500 for each dependent.
— not own property of more than $2000 in value after deducting the amount owed to secured creditors.
— not own property capable of producing more than $500 on realization, after deducting property that is exempt from execution by provincial law.[4]

Through the years, the maximum income levels have been raised and the criteria broadened but the program continues to be designed to assist people whose debts have arisen through the consumer market rather than through business.

The Study

This inquiry was based in Winnipeg, Manitoba where the assistance program was introduced during the summer of 1973. Files were selected randomly from the records of the Federal Trustee's Office for the years 1973-1977.[5] Information was obtained through the use of questionnaires as well as personal interviews with bankrupts and their families.

The descriptive analysis of the data in this study provides an answer to questions such as: Who goes bankrupt (sex, age, income, education, family structure, etc.); what are the alternatives tried before bankruptcy; what are

3. R.S.C. 1970, c. B-3.
4. Consumer and Corporate Affairs, *Report of the Superintendent of Bankruptcy* (March, 1973) 39.
5. One hundred and forty-six files were selected. Letters explaining the purpose of the study were sent as the first contact to all persons included in the sample. About 80 percent of the letters were returned because addressees had moved. Forwarding addresses were not available. Forty-three of the bankrupts (20.6 percent of the sample) were contacted by telephone, seventy-two percent of whom agreed to participate in the study. Of these, 14 were unable to give time for personal interviews due to their irregular work schedules, but were willing to complete the questionnaire. Questionnaires were mailed to the 14, 9 of whom completed and returned them. This study is based therefore on the bankruptcy experiences of only 31 respondents and their families. As displayed in Table 1, it appears most of the respondents were from either 1976 (39 percent) or 1973 (29 percent). There was a very small representation from years 1974, 1975, and 1977.

the influences from those who are contacted by bankrupts; what is the general level of the bankrupts' satisfaction with the program; what was learned by bankrupts from the experience; and how has the experience of bankruptcy affected their personal and social lives.

Who Are The Bankrupts?

A large majority (71 percent) of the bankrupts included in the study were married and were between 31 and 50 years of age. Two thirds of the bankrupts were male. About 80 percent (25 families) of the respondents have dependent children.[6] This fact underscores the vulnerability of those segments of the population that become overburdened by debt.

Only 19 percent of the 31 respondents have incomes equal to or above $10,000 annually. The remainder are in the $6,000 to $7,999 a year income bracket, with 19 percent below the $5,900 level.[7] Considering the large percentage of those who have children, one must to some extent question the judgment of the credit grantors, particularly when education and training levels do not appear to indicate accelerating earning capacities. This is not to say that only those of modest incomes are driven to bankruptcy, as this study inquired into personal bankruptcy under the Small Debtor Program only. The findings indicate clearly, however, that the low income earners are most vulnerable.

Alternatives to Bankruptcy

Although declaring bankruptcy is on the increase, people find this a difficult decision to make. According to the Federal Trustee's office, in Manitoba, 35 to 40 percent of the persons who initially apply for bankruptcy under the program decide that they do not wish to proceed formally. This study confirmed that most couples discussed several alternatives to bankruptcy before reaching a final decision.

More than half the families (52 percent) tried to resolve their indebtedness by negotiating new terms of repayment with creditors, and did not succeed. In most cases, creditors were unwilling to take the risk of re-writing loan arrangements on accounts that were already seriously overdue. About 13 percent tried unsuccessfully to consolidate their debts and about one fourth (60 percent) of those interviewed tried to seek help through the Orderly Payment of Debt Plan.[8] To a lesser extent, advice was sought from Legal Aid, and one respondent tried to borrow money from friends.

It is interesting to note only 23 percent of the families made the decision to declare bankruptcy without consulting some form of advisor. The most commonly consulted advisors were: debt counsellors (13 percent), Orderly Payment of Debt (26 percent), social workers (6.5 percent), lawyers (16 percent), and friends (16.2 percent).

More than half the respondents (54 percent) delcared bankruptcy because of extreme pressure from their creditors to make payments. Accor-

6. *See* Appendix, Table 2.

7. *See* Appendix, Table 3.

8. The Orderly Payment of Debt plan is provided for by Part X of *The Bankruptcy Act, supra,* n.3. It is basically a court operated debt pooling plan where all interest rates are reduced to 5% per year.

ding to the bankrupts it was the finance companies who pressured most strongly (50 percent), followed by department stores (26 percent), banks (13 percent), utility companies and others (10 percent).

Satisfaction of Bankrupts with the Small Debtor Program

Eighty percent of the respondents expressed positive feelings about the Small Debtor Program. Clearly, they felt a great sense of relief and well being as a result of being able to "get a new start." Specific reasons for satisfaction with the program were "gave a sense of relief" (40 percent), "improved family situation" (25 percent), "saved job" (10 percent), "saved from creditor harrassment" (25 percent). The majority of respondents were also very pleased with the "good treatment" and "efficient work" of the bankruptcy office staff. A small minority (20 percent) who were not satisfied with the process, felt that it was too easy a way to relinguish one's responsibility and that the process did not provide adequate information about their "present and future status." This group believed not enough time was spent with them in explaining the procedure and stated that they were hurried through the program.

It is important to note that there was a distinct difference between the comments made by the people declaring bankruptcy in the years 1973-1974 and those going through the program in the years 1975-1977. The earlier group expressed greater satisfaction with the program and this is undoubtedly related to the fact that in the earlier years more time was spent with the bankrupts on rehabilitative activities. Those discharged in later years were grateful to be given a new start, but learned little about the functioning of the credit system or financial management skills. Some expressed concern about not understanding the process they went through and their position in the future.

Effects of Declaring Bankruptcy on Family's Borrowing Practices and Money Management Skills

Analysis of the debt structure of the bankrupts' records showed that, at the time of filing for bankruptcy, this group had borrowed, on an average, $6,700 from multiple sources. The data also indicated that for about one half the group (45.5 percent) the debt income ratio was very high, i.e., between 1 to 1.5. This means, a family with an annual income of $6,000 carried consumer debt (excluding mortgage) from $6,000 to $9,000. There seems to be a consensus among the experts of the finance industry that a debt to income ratio of .30 to .50 is the maximum burden a family should carry. This guideline, however, assumes that the income level of the family will be continuous.

Findings of this study reveal significant changes in the borrowing practices of the family after the experience of bankruptcy.[9] Most of those interviewed (58 percent) stated they did not use credit at all, and further more, they no longer believed in "buy now, pay later." They had decided to limit their expenses to their incomes. They expressed the view that "too much credit was available" and "the system makes it too easy to borrow". Discussion of their responses to the question "What did you learn from this

9. *See* Appendix, Table 5.

experience?" also shows that most of these people were afraid of using credit again. The responses to the specific question "where do you like to borrow money now?" further conformed a significant changed in their attitude toward credit. A majority of those using credit (61 percent) now preferred to borrow from banks and credit unions. This was a significant change, as the information from their files at the time of filing bankruptcy had shown that finance companies were the major source of borrowing for this group (61 percent of the total debt outstanding).

Many bankrupts (45 percent of the sample interviewed) still had no idea of the cost of revolving charge accounts. Twenty percent thought the cost was 11 to 16 percent, whereas the remaining 35 percent said the cost was 20 to 24 percent, the actual cost being 18 percent per annum. From the interviews it was apparent that many of the bankrupts were very keen to learn more and "to do the right thing," but had very limited knowledge about the existing credit system.

During investigation of bankrupts' records, it was found that every file carried an explanation of the causes of bankruptcy. In general, the explanations were provided by the bankrupts. In the absence of such information, a remark was made by the trustee as to the cause of bankruptcy based on the evaluation of the case. Analyses of those records showed that in more than half of the cases (52.1 percent) the cause of declaring bankruptcy was associated with lack of prudent financial management.

Most families in this study did not view income planning as a major variable in their situations, but saw income as an external factor over which they had no control. Every participant in the study was asked specific questions on budgeting practices. Approximately 60 percent mentioned that they gave very little thought to planning their expenses before declaring bankruptcy. About 16 percent said they did not have enough money to budget, and the remaining 24 percent thought they *were* budgeting their family finances. Their budgeting practices consisted of priorizing bills, knowing their expenses and keeping records. It should be noted that responses to another question, "are you doing anything different about managing your money now?", showed that a significantly large number (65 percent) budgeted their family finances after declaring bankruptcy. Their specific practices consisted of use of less credit, record keeping, use of cash only, and saving money.

It was also apparent during the interviews, that the bankrupts who appeared to have made the most progress in rehabilitation were those with whom the administrators of the bankruptcy program established good working relationships and had gained confidence to the extent that all or most problems relevant to the bankruptcy were discussed and some steps were taken to solve them.

Effects of Declaring Bankruptcy on Family's Social and Marital Life

It is generally believed that, among many other factors contributing to the increasing number of personal bankruptcies, people feel less stigma attaches to declaring personal bankruptcy. The findings of this study, however, do not seem to concur with that belief. During the interview it was observed that almost everyone went into great lengths to justify the reason for his or her filing for bankruptcy. When asked if they felt a stigma about declaring bankruptcy, almost 90 percent said no. But it was learned in later interviews that, generally, plans to declare bankruptcy had been kept secret from everyone, even from the family members.

This topic was pursued further by asking the bankrupts two more questions: 1) "How did going through bankruptcy affect your social life?" and 2) "How did going through bankruptcy affect your marriage?".

One third of the bankrupts felt that their social life had improved as a result of declaring bankruptcy. They qualified the statement by saying that not having to worry about debt helped them to enjoy life more than they had been able to before going through bankruptcy. On the other hand, about 40 percent perceived few effects, and 19 percent were uncertain. The significant fact is that a large number of these people told no one about their bankruptcy, showing that there is still some stigma attached to the phenomenon.

The majority (58 percent) of respondents felt that going through bankruptcy had no effect on their marital life. One third (35.5 percent) of those interviewed, however, felt this experience had a positive effect on their marriage. Relief from debt burden had reportedly helped some couples to build better relationships, while previously the pressure of too much debt and related problems were causing marital problems. It also was evident that for a small number of people (6.5 percent) the pressure of the situation leading to bankruptcy was too much, and that the bankruptcy experience proved to be the last straw in their strained relationships, leading to divorce or separation.

Conclusion

Although bankrupts expressed general satisfaciton with the existing bankruptcy program, they did have some suggestions for improvement of the program. They felt the existing program could have far-reaching effects on the rehabilitation of bankrupts if it emphasized: (a) the provision of information on credit buying, (b) financial counseling where needed, (c) more information about the procedure and the status of the bankrupt.

It can be safely concluded that, although the objective of the bankruptcy process (ie. relief from debt) was generally obtained by those interviewed, these people were in great need of information and education on consumer debt and money management. It is evident that some effort should be made through the bankruptcy program to expedite the re-integration of the debtor in the economic circuit. The program should include some element of family financial counselling or a system of referrals to a financial counselling agency. Bankruptcy should provide more than just immediate relief. It should educate people to deal more effectively with today's complex and cashless market system.

APPENDIX

TABLE 1

Description of Bankrupts by Year or Filing for Bankruptcies

Year	Number (N = 31)	Percent
1973	9	29.03
1974	3	9.70
1975	2	6.45
1976	12	38.70
1977	5	16.12

TABLE 2

Distribution of Bankrupts by Age, Sex, Marital Status and Number of Children

Variable	Number (N = 31)	Percentage
Age		
21-30	5	16.0
31-40	11	35.5
41-50	12	38.7
51-over	3	9.7
Sex		
Male	21	67.7
Female	10	32.2
Marital Status		
Single	5	16.1
Separated	2	6.4
Divorced	2	6.4
Married	22	71
Number of Children		
0	6	19.3
1	7	22.6
2	11	35.5
3	3	9.7
4	1	3.2
5	2	6.4
6 and more	1	3.2

TABLE 3

Distribution of Bankrupts by Type of Employment, Income and Education Level

Variable	Number (N = 31)	Percentage
Types of Employment		
Unskilled	6	19.3
Service	9	29.0
Blue Collar	9	29.0
Professional	1	3.2
Skilled	5	16.0
Unemployed	4	13.0
Annual Income (at the time of Bankruptcy)		
\$3,000 to \$3,999	2	6.4
\$4,000 to \$4,999	2	6.4
\$5,000 to \$5,999	2	6.4
\$6,000 to \$6,999	10	32.3
\$7,000 to \$7,999	9	29.0
\$10,000 or over	6	19.4
Years of Education		
5	1	3.2
5-8	7	22.6
9-10	9	29.0
11-12	13	42.0
13	1	3.2

TABLE 4

Best Things About Bankruptcy Program

Best Things	Numbers (N = 31)	Percentage
Helps to have a new start	10	32.2
Helps to get rid of credit or harrassment	4	12.9
Easy way to get out of trouble	15	48.4
Educates on money management	2	6.5

Chi-square statistics significant at 0.1 level

TABLE 5

What Bankrupts Learned From Their Experience

Learning Experience	Number (N = 31)	Percentage
Charge carefully	7	22.6
Always use cash	12	38.7
Don't borrow from a finance company	4	12.9
Budget your money	7	22.6
Learn more about credit system	1	3.2

Chi-square statistics significant at .01