Insolvency is expected to spike when COVID-19 aid ends — here's what you might need to know

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Last Friday, the Bank of Canada echoed a warning by the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) that personal insolvencies may spike, once the federal government's protections in the wake of the COVID-19 pandemic wind to a close.

After climbing steadily over the past year, the number of Canadians who filed for insolvency during the first quarter of 2020 decreased by 5.5 per cent compared to the previous quarter, according to the Office of the Superintendent of Bankruptcy, and 8.5 per cent lower than the same quarter in 2019.

"Before the pandemic, we knew from surveys that 42 to 52 per cent of Canadian households were living paycheque to paycheque," said André Bolduc, an executive board member of CAIRP and a licensed insolvency trustee (LIT). "Now, with everyone losing their jobs, income is impacted and the government stepped in. Once that support runs out, the issues will still be there, and the problems may be amplified. Mortgages will come due and there will no longer be deferrals available, for example."

In its May 14 Financial Systems Review, the Bank of Canada stated, "Household employment incomes have been hit hard, and many Canadians face financial difficulty, especially those that are already highly indebted.

"The longer the income shock lasts, the greater the risk if a rise in consumer insolvencies."

Ricardo Tranjan, senior researcher/political economist with the Canadian Centre for Policy Alternatives, agrees that an increase in insolvencies is quite probable once pandemic protections disappear. He is most worried about lower- and middle-income families, while Bolduc cites concerns about workers in the restaurant and entertainment industry.

"There are a lot of people on social assistance who count on employment income to supplement their basic needs," Tranjan said. "Some qualify for the Canada

Emergency Relief Benefit for now, but some are so vulnerable that any loss of income could render them homeless, and it’s tough to get them back once they cross that line.

“Even for moderate income families with two incomes, the cost of living means they can put little money away, given child-care costs and the rising price of food. Their expenses are high and their savings are low, so there is a risk of high debt.”

Tranjan fears that people living close to the edge will turn to payday loans, even with their extraordinarily high interest rates, to help them get by.

“These people usually have unequal access to financial products like lines of credit, so filing for insolvency and bankruptcy protection might be better than going to a payday lender and falling deeper into debt. This way, they can try to restart, rather than paying debts at any cost.”

Bolduc and Liisa Tatem, a certified financial planner with Money Coaches Canada, each advocate getting a handle on your cash flow before your finances reach the crisis stage.

“It’s something that everyone should review before things become desperate,” Tatem said.

Once you realize that there’s a problem brewing, it’s time to ask for assistance.

“The sooner you seek help, the better the options are and the more likely you are to turn things around,” Bolduc said.

The first step, says Tatem, is to see a credit counsellor — one who is legitimate. Check with the Financial Consumer Agency of Canada for recommendations.

“They can talk to your creditors for you and try to arrange a deal. If that doesn’t work, you’ll need to talk to a licensed insolvency trustee and consider a consumer proposal or, as a last resort, a declaration of bankruptcy.”

An LIT, who is licensed by the federal government to administer proposals and bankruptcies, first meets with a prospective client — generally free of charge — to assess their financial situation.

“We look at all the options: can you budget your way out? Do you need a consolidation of debt? Do we need to do a consumer proposal for you or is declaring bankruptcy your only choice?” Bolduc said.

With a consumer proposal, the LIT negotiates a settlement with all of the creditors, who can vote to accept or veto the proposal. An accepted proposal usually extends over a five-year term and requires the party in debt to make a monthly payment to the LIT for distribution to those creditors, but the person in debt is allowed to keep all assets.

Bankruptcy is generally a last resort and may be declared if it looks as if a person doesn't have sufficient income for monthly payments and/or has no assets. The trustee takes control of most assets, with some exceptions, such as RRSPs and tools needed to earn income, and sells them to pay creditors. Bankruptcy generally carries a stigma, but it eliminates debt, puts a stop to wage garnishment and ends collection calls.

Once life returns to something approximating normal, Tatem suggests, "Before people ramp up their spending again, it's time to ask themselves, 'Do I need to add this back in?'"

Tranjan would like to see larger-scale changes.

"At the systemic level, we need lower-cost essential services so that people can spend less on the necessities," he said. "They spend too much on services like transit that should be subsidized on a basic level."