

Drowning in Debt?

If your divorce has left you drowning in debt, credit counseling, a Consumer Proposal, or even filing for bankruptcy can throw you a lifeline. Here are some strategies for ending your post-divorce credit woes.

By Jeffrey Cottrill

A long marriage usually creates a firm financial stronghold and system for a couple. When the couple gets divorced, the system suddenly gets shattered: assets and debts must be split; a spouse who may have largely depended on the income of the other may be up a creek without a paddle -- and, unfortunately, you may end up with a lot of excess debt. Sometimes, if the divorce is very bitter, the legal and other professional fees can add up to impossible levels; other times, you end up unexpectedly saddled with your ex's debts. Just having a decent place to live can make it worse if you go out on your own or with your children -- especially in areas where housing is extremely expensive. "Unfortunately, divorce and money problems tend to go hand-in-hand, no matter which is the chicken and which is the egg," says Janet Humes, a Chartered Accountant and trustee in bankruptcy with Horwath Orenstein, which serves the Greater Toronto Area.

If divorce has left your finances in ruins, you need to find a way to get back on your feet. There may be several options open to you, depending on your unique situation and credit history. One is filing for bankruptcy; another is finding a way to pay off your debts -- at least to a point where creditors temporarily won't harass you. This may, of course, be impossible -- and unfair to you, depending on the situation (you may not have expected or meant to get in so much debt through your divorce in the first place).

If your income is relatively high, or if you feel that the debts are primarily your responsibility and can realistically pay them over the long run, you may be wisest to do so. You could also consider selling off some of your assets to pay your creditors, which will keep your credit rating in good standing.

Another solution is to have a credit counselor work out an easier payback plan for you. "With credit counseling, it really depends on the value you get for your money," says Dave Fry, a bankruptcy trustee with Clarke Henning in Toronto. "You may have enough money to handle your debts but need coaching. Debt consolidation and refinancing are for those who can handle their debtload but need assistance and management advice. There's no point in going bankrupt for a small amount of debt; you should be able to handle minimum payments and get it under control if the total amount is small."

In Ontario, the Ontario Association of Credit Counselling Services (OACCS) can help you contact your nearest responsible credit counseling service. They can be reached at (800) 263-0260 or via e-mail at oaccs@passport.ca. Other provinces have credit counseling available, either through the provincial government or non-profit agencies.

Credit-counseling services (CCS) or debt-consolidation companies generally offer to help you by reducing all your debts to one affordable monthly payment. These companies contact your creditors on your behalf, and they try to renegotiate the remaining balance, the interest rate, or both.

You'll make small, monthly payments directly to a CCS, but your creditors usually absorb the lion's share of the fees. As with any company you're considering hiring, you should ask the CCS for references, and investigate before signing on the dotted line. Keep in mind that there may be hidden costs that they don't tell you about, which could make your financial woes even worse.

You also need to know that credit counseling could have a negative impact on your credit report, since your creditors might report that the original balance was renegotiated. But that shouldn't stop you from considering the process: it can be a lifeline when you're drowning in debt.

You could try to negotiate deals with your creditors yourself to get your payments down to a manageable level, but this may be very difficult. It may be easier to restructure your mortgage or car payments in order to make your full debt load easier to handle.

But this solution is only viable if you actually have the ability to pay. "Often, I end up seeing people after they've tried consolidating loans; they can't pay off either the original debt or the consolidation," explains Humes. "And I've seen the negative effect of borrowing from friends and relatives. There's no magic solution: you either pay the debt or try other alternatives. It's your choice: you should explore other options if you're uncomfortable with bankruptcy."

Bankruptcy

The good news is that going bankrupt (like divorce itself) doesn't carry as much of a social stigma as it once did. It's also usually not as disastrous or terrible as you may believe. Although the word "bankruptcy" might stir up thoughts of poverty, failure, confiscation, or just plain guilt, the fact is that bankruptcy is more common today than ever before. "Bankruptcy is one of the least understood processes in our legal system," notes Frank Kisluk, another trustee, in his book *Life after Debt* (Doubleday Canada, 1996). "Even though tens of thousands of individuals file for bankruptcy in Canada every year, the process is a private affair."

It's not the end of your life or career, not even financially. Desperate to get blood from a stone, some creditors will tell you that bankruptcy is financial suicide, but remember that this is a cheap scare tactic designed to make you give in. Whether your debt problems resulted from a financially chaotic divorce, bad business decisions, a scam, or just personal carelessness, you should look upon bankruptcy as a chance to start anew. If it goes through without any hassle, you'll end up with a clean slate and your debt worries over.

That doesn't mean that you'll escape scot-free. You may have to give up a lot in return for a simpler lifestyle; you will have to pay for a trustee to handle your case and your assets; and you won't be able to use credit for several years. In fact, bankruptcy may not be the most viable solution for your own situation. Although it will eliminate most of your debts and give you a fresh start, it is still an enormously important decision to make and a relatively traumatic process to undergo. This article is designed to give you an overview to help you consider whether bankruptcy is the solution for you.

How does it work?

In Canada, The Bankruptcy and Insolvency Act (or BIA) lays out the rules for bankruptcies and Consumer Proposals. Under this legislation, a person who can't pay off his or her debts is "insolvent" and one who has sought legal protection from his or her creditors is "bankrupt". You can be insolvent without being bankrupt, but not vice-versa.

In basic Canadian consumer bankruptcy, all of your debts that are considered dischargeable are eliminated. Debts that are generally not considered dischargeable include income taxes, student loans (unless you've been out of school for at least 10 years), spousal and child support, and any debts resulting from fraud, penalties, or misappropriation. "Nine months is the normal period for bankruptcy," says Fry, "and then there's usually an automatic discharge." If none of your creditors nor the Superintendent of Bankruptcy (who oversees the implementation of the BIA) opposes your discharge, you're free. But before that happens, you may have to hand some assets to your trustee to sell, after which he or she will distribute the funds to your creditors.

"Bankruptcy law is federal, but the exemption laws are provincial," says Humes. "The Ontario Executions Act is very different from what western provinces have, for example. In Ontario, up to \$5,000 of clothing is exempt; the limit on household goods is \$10,000, tools of the trade \$10,000, and a vehicle, \$5,000. With homes, it depends on the equity." Bankruptcy won't ever exempt you completely from automobile or mortgage payments; you remain responsible for them if you plan to hold on to your house or car.

If you're uncomfortable with declaring bankruptcy -- or you feel that you can pay most or all of your debts over a longer period of time -- you may want to consider a Consumer Proposal. In this case, you offer your creditors payment (via your trustee) over a longer period of time for a lesser amount or at a lower interest rate. "I'll recommend a Consumer Proposal if I think a person has a high-enough income that he or she can afford to do it," says Humes. "Often people feel better about a Consumer Proposal than bankruptcy. It depends on the financial ability and how the person feels."

"You might consider a Consumer Proposal if you have assets to protect, equity in your house, RRSPs, or just a larger income," says Fry. This way, you don't risk losing as many of your assets -- or harming your credit rating any further. If your creditors object to your proposal, however, bankruptcy may be your only option.

The pros and cons

Once you've successfully filed for bankruptcy, you're immediately protected from the harassment, threats, and possible lawsuits of creditors -- and once your bankruptcy is discharged, most or all of your debts are gone. Similarly, if you comply with your Consumer Proposal plan, your creditors cannot hound you.

"An advantage -- and one of the purposes -- of bankruptcy is that it's an opportunity to make a new start and get out from underneath overwhelming debt," says Humes. And Fry adds, "The biggest advantage of declaring bankruptcy is that you get peace of mind. You get out from under a burden that you can't deal with, assuming you accumulated the debt in a legal manner."

However, bankruptcy does have serious consequences to consider. A recent bankruptcy on your record will make it very difficult or impossible to obtain credit for a while. "The disadvantage is the effect on your credit history," says Fry. "It stays on your record for six years after your discharge. It doesn't mean that you can't get credit, only that potential creditors know what you've gone through already, and that makes it more difficult."

"Not only is there a very negative impact on your credit rating, but your assets come to the trustee, so you may lose some of your assets," says Humes. "It depends on the individual situation."

Bankruptcy isn't a loophole that gives you the freedom to take advantage of creditors: it's a financial lifeline that helps you start with a clean slate when you desperately need it. Bankruptcy may be the only way out when your debts result from poor financial decisions, household repairs, or divorce-related fees. But it's not a license to go on wild shopping sprees that you'll never be able to pay for.

So despite the relief that bankruptcy provides, it's not a decision to be taken lightly. And as we'll see later, it's definitely not a way of getting out of your spousal or child support obligations. Bankruptcy should be considered a last resort after you've examined all other possible options.

Can your ex-spouse's bankruptcy affect you?

Yes. A problem that occasionally occurs when a divorced person files for bankruptcy is that his or her ex-spouse gets stuck with some or all of the debts. Suppose that your ex-spouse owes \$50,000 on credit cards, and your divorce agreement states that both of you share the debt. If your ex declares bankruptcy, you'll be saddled with the entire \$50,000. The law tends to see people as being responsible for their spouses' debts, so it's important to get who owes what straightened out before and/or in your divorce agreement.

"One of the biggest problems we see is with joint credit cards," says Fry. "For example, when someone maxes out his wife's cards out of revenge or retribution." So if you've just separated, and you think your spouse may have a vengeful streak (or just shopaholic tendencies), make sure to cut up those cards!

Be aware, too, that if your ex-spouse files for bankruptcy, you're only protected if the debt is in his or her name and not in yours. For example, if your divorce agreement specifically states that your spouse will be solely responsible for your credit card debt, but the cards are in your name, then creditors will come after you after he or she files.

You can't use bankruptcy as an excuse to get out of support payments. Spousal and child support are undischargeable debts. Although bankruptcy cannot eliminate support obligations, it can make them easier to adhere to simply by eliminating other debts. Some trustees might even recommend bankruptcy as a way to meet your support payments -- simply because it lightens the whole load.

So don't worry about losing your ex-spouse's support payments because he or she filed for bankruptcy. Instead, be concerned with any loose ends of joint debt that weren't cleared up before the divorce.

Just like starting over...

Contrary to the traditional image of bankruptcy as a shameful, destitute state, it has become a way of getting back on your feet after financial disaster. Few people who file for bankruptcy are irresponsible deadbeats; many just made poor judgments or had a run of bad luck. In the long run, bankruptcy could be a positive decision. However, make sure to consider it thoroughly before you choose to file. Weigh the pros with the cons; analyze your current situation and whether other alternatives would be more effective; think about everything you have to gain and lose; and if you choose to file, make sure you never, ever have to do so again.

For more information on bankruptcy laws, procedures, and the exemptions and rules in your province, speak to a local, licensed bankruptcy trustee. "It's standard practice to have a first free session," says Humes. "I tell people that there's no obligation -- feel free to get the information to find out what's involved and make an educated decision. Don't put it off: be proactive. Information is a relief; often things are not as bad or difficult as you thought."