

For the financially distressed individual (referred to as the "debtor"), the first option often contemplated is filing for bankruptcy. Although the debtor will find relief from his creditors, this option has some disadvantages:

Proposals to Creditors - Let's Make a Deal

- Upon filing bankruptcy, the debtor's credit rating goes to an "R9" with the credit bureau and remains so for 6 years after the debtor is discharged from bankruptcy.
- With some exceptions, the debtor's assets become property of the bankruptcy trustee. This becomes a particularly important issue if the debtor owns a home with substantial equity.
- Although attitudes are changing, there is still a stigma attached to the concept of filing for personal bankruptcy.

Given the above points, it would be prudent to consider an alternative to bankruptcy when a debtor is dealing with creditors. The best alternative is called a "proposal" to creditors.

What is a proposal?

Simply put, a proposal to creditors is a formal repayment plan governed by the Bankruptcy and Insolvency Act. Assuming the debtor's total debts do not exceed \$250,000 (this threshold excludes mortgage debt on a residential home), the steps in the proposal process are as follows:

1. The debtor initially seeks the assistance of a trustee in bankruptcy to answer the following questions:

- Will the debtor be able to fund a proposal? That is, does he have adequate income to pay into a proposal after his/her living expenses? Or alternatively, can he fund the proposal by voluntarily liquidating his assets or obtaining the financial assistance of friends/family?
- How much should be offered in the proposal; what can the debtor afford to pay and what will the creditors accept?

2. The trustee will work with the debtor in drafting a proposal to his creditors.

3. The proposal is then filed with the Office of the Superintendent of Bankruptcy (a division of the federal government that monitors bankruptcy and insolvency proceedings in Canada). Upon filing the proposal with the OSB, creditors are legally stopped from taking any action against the debtor or his property.

4. The proposal and the debtor's financial information are mailed to the creditors for their review. A document called a voting letter, which allows a creditor to indicate its vote, is also sent. Creditors are required to file with the trustee a proof of claim and completed voting letter before their claim can be registered for voting on the proposal.

5. At the end of the 45-day period after the proposal was filed with the OSB, the trustee will compile and review the voting letters received. There are 3 possible scenarios:

- If no voting letters were received, the creditors are "deemed" to have accepted the proposal.
- If those creditors voting "no" comprise less than 25% of the value of claims filed, the creditors are deemed to have accepted the proposal.
- If those creditors voting "no" comprise more than 25 percent of the value of claims filed, the trustee is required to hold a meeting of creditors. Creditors will usually vote "no" because they want more money. Therefore, a meeting of creditors would be held to discuss what the debtor would have to offer in a proposal before it would be accepted by the dissenting creditor(s).

6. Once the creditors have accepted the proposal, there is a 15-day waiting period that allows any interested parties (e.g., creditors, the trustee, or the OSB) to request that the bankruptcy court review the proposal. Once that 15-day period expires, the proposal is deemed to be accepted by court.

7. If the proposal is not approved by the creditors and the court, the debtor is essentially in the same position he was prior to filing – at the mercy of his creditors. In that event, he may have to consider filing for bankruptcy. As mentioned, the above scenario applies if a debtor's non-mortgage debt does not exceed \$250,000. This type of proposal is called a "Consumer Proposal". If debts exceed \$250,000, the process is somewhat more complex, and will be the subject of a future article – "Division I Proposals – Let's Make a Deal, Part 2".

What are the consequences of filing a proposal?

A debtor's credit rating will be downgraded to an "R9" rating with the credit bureau during the performance of the proposal. Once the proposal is completed, the credit rating will be upgraded to "R7", and will so remain for 3 years. After 3 years, the R7 is deleted from the debtor's credit file.

If the debtor fails to complete the proposal, then he is essentially in the same position he was prior to filing –

“The proposal offers a viable and attractive alternative to bankruptcy...”

at the mercy of his creditors. In that event, he may have to consider filing for bankruptcy.

Conclusion

The proposal offers a viable and attractive alternative to bankruptcy and has been steadily gaining popularity over the past several years:

- From the debtor's standpoint, it offers flexibility in that a repayment plan can be tailored to the debtor's ability to pay. It also minimizes the impact on his credit rating.

- From a creditor's standpoint, a proposal is advantageous in that creditors will receive more money in a proposal than in a bankruptcy.
- From a social perspective, the proposal process enables the debtor to settle with creditors and encourages personal responsibility for the repayment of debts.

Victor Fong, CMA, CIRP
Trustee in Bankruptcy
victor@fongpartners.com

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Fong and Partners Inc.
Trustee in Bankruptcy
Scarborough • Toronto • Brampton
T 416.260.3264 F 416.323.5248
www.startingovertoronto.com