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WEALTHYBOOMER

Crushing Debt: The 4 main options

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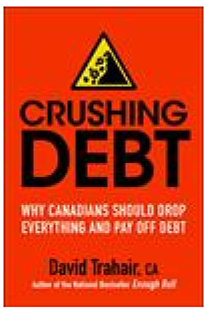

About a year ago, a couple I know well were seriously contemplating bankruptcy but were at a loss for finding a neutral source of information about their options. Today, I'd have no hesitation in directing them to a new book just published by chartered accountant David Trahair: *Crushing Debt*.

Subtitled *Why Canadians Should Drop Everything and Pay Off Debt*, the relevant chapter for my friends would be Chapter 7: *How to Get Out of Personal Debt*. I read it cover-to-cover on the weekend and found it a surprisingly compelling read.

There's plenty of material on sovereign debt and the fact that Canada is hardly immune from what's going on in Europe, the U.S. and elsewhere. Debt is also a major theme of another book that won't be out for another month or so: *Financial Recovery in a Fragile World*, by Evelyn Jacks, Al Emid and Robert Ironside.

FinancialPost.com

David Trahair

More on that later but back to Trahair's book, one of a flurry of books published this autumn by Wiley Canada. Trahair has also published an RRSP book called Smoke & Mirrors and another Wiley book, Enough Bull. The former questioned a lot of conventional wisdom about RRSPs and retirement (such as the perception you need $1 million to retire). The latter questioned the equity culture of the financial industry and essentially counselled concentrating on fixed-income and GICs.

Being free of all debt a prerequisite for Retirement

Because he's an accountant rather than a financial planner or securities salesperson, Trahair's insights are relatively objective and no-nonsense. I'm completely aligned with his view that there's little point in building wealth while you're still mired in the basement of debt. (To paraphrase a line from my own book).

I wrote "the foundation of financial independence is a paid-for home." Trahair says the same thing in different words: "If you want a comfortable retirement your goal should be to retire debt-free, including the house mortgage."

To return to the situation my friends were facing a year ago, here are the four options they had; I've used Trahair's headings and have paraphrased and condensed his content:

1.) Paying off your debts yourself.

This is the old-fashioned route I'd hope most of us would take, providing we still have employment income and we're not too deeply in the hole. My friends had long passed this option, however. The objective here is to pay off all your bills, both principal and interest. You stop accumulating expensive assets and try to sell some of them; you get a debt-consolidation loan and/or try to renegotiate your debts with your various creditors.

2.) Use a credit counselling service's Debt Management Program

This option involves paying back principal but arranging to get a partial or total break on interest owed. The credit counselling agency contacts your creditors and coordinates payments to them on your behalf. You make one monthly payment to the agency, which they then distribute to your creditors. One of the several benefits is that phone calls from creditors will stop.

3.) Use a Bankruptcy Trustee to file a Consumer Proposal

As Trahair notes, if you don't think you can pay off 100% of your debts, a DMP may not be for you. He defines a consumer proposal as a "negotiated offer to all of your unsecured creditors to pay a portion of what you owe." That includes credit card debt, unsecured lines of credit, personal loans, payday loans and income taxes.

This is an alternative to outright bankruptcy but it still is administered by a licensed Bankruptcy Trustee. You negotiate to pay less than 100% of your debts and all interest charges stop as soon as you file the proposal. You don't lose your house or other assets, and the negative impact on your credit rating is less severe than under bankruptcy. The maximum repayment period is five years. This may be the best choice if you owe $5,000 to $250,000, not including your mortgage. (A proposal does not deal with secured debt like a home mortgage or car loan.)

4.) Use a Bankruptcy Trustee to file bankruptcy.

This of course is the last resort but Trahair says "for some people it is the best option." You're just so deep in debt there's no other way out. But you can't do it on your own: you must use a professional. It's a legal process that can only be filed through a Trustee in Bankruptcy, someone licensed by the Office of the Superintendent of Bankruptcy to administer the process.

Trahair cautions that bankruptcies usually do not affect the rights of secured creditors with valid security against such property as your house or car. "Bankruptcy will not wipe out your mortgage or your car loan."

The trustee will try to sell some of your assets, although some are exempt because of provincial or federal laws. The proceeds will be held in trust for eventual distribution to your creditors. Exempt assets include up to $11,000 of household furniture (in Ontario), personal effects, vehicles worth under $5,650 (in Ontario), tools of the trade, and RRSPs (except for contributions made within 12 months of the bankruptcy).

During this time, you may be required to make payments to the trustee for later distribution to creditors. You may have to meet with them and will have to attend two counselling sessions. If all conditions are met, you will be discharged nine months after filing for bankruptcy.

All in all, if you're drowning in debt, the $19.95 spent on Trahair's book will be money well spent.