

CRUSHING DEBT

**WHY CANADIANS SHOULD DROP
EVERYTHING AND PAY OFF DEBT**

David Trahair, CA



John Wiley & Sons Canada, Ltd.

Copyright © 2012 by David Trahair

All rights reserved. No part of this work covered by the copyright herein may be reproduced or used in any form or by any means—graphic, electronic or mechanical—without the prior written permission of the publisher. Any request for photocopying, recording, taping or information storage and retrieval systems of any part of this book shall be directed in writing to The Canadian Copyright Licensing Agency (Access Copyright). For an Access Copyright license, visit www.accesscopyright.ca or call toll free 1-800-893-5777.

Care has been taken to trace ownership of copyright material contained in this book. The publisher will gladly receive any information that will enable them to rectify any reference or credit line in subsequent editions.

The material in this publication is provided for information purposes only. Laws, regulations, and procedures are constantly changing, and the examples given are intended to be general guidelines only. This book is sold with the understanding that neither the author nor the publisher is engaged in rendering professional advice. It is strongly recommended that legal, accounting, tax, financial, insurance, and other advice or assistance be obtained before acting on any information contained in this book. If such advice or other assistance is required, the personal services of a competent professional should be sought.

Library and Archives Canada Cataloguing in Publication Data

Trahair, David

Crushing debt : why Canadians should drop everything and pay off debt/
David Trahair.

Includes index.

ISBN 978-1118092200

1. Finance, Personal—Canada. 2. Debt—Canada. I. Title.
HG179.T715 2011 332.024'02 C2011-902456-X

ISBN 978-1-118-09605-5 (ePDF); 978-1-118-09607-9 (eMobi);
978-10118-09606-2 (ePUB)

Production Credits

Cover design: Adrian So

Interior text design: Thomson Digital

Typesetter: Thomson Digital

Printer: Solisco Tri-Graphic

John Wiley & Sons Canada, Ltd.

6045 Freemont Blvd.

Mississauga, Ontario

L5R 4J3

Printed in Canada

1 2 3 4 5 STG 16 15 14 13 12

CONTENTS

Acknowledgements	ix
Introduction	1
Where I am Coming From	2
A Word about Books	3
The World is on the Edge of a Cliff	4
It Ain't Gonna be Easy, But There is Hope	5
Why I Wrote This Book	6
What Will You Learn	7
Chapter 1—Debt: The Snake in the Closet	10
My Own Story	10
Chapter 2—Why is the Consumer Debt Crisis So Bad?	16
Human Nature	16
The Environment	20
A Financially Illiterate Consumer is a Bank's Best Customer	24
Consumer Financial Education: Why is It Missing?	24
Look at What Happened in the United States	25
Chapter 3—The U.S. Subprime Mortgage Disaster	26
The Perfect Debt Storm	27

CONTENTS

My Trip to Slavic Village, Cleveland, Ohio	28
Why the Crisis Spread	30
Houses “Under Water”	31
The Current U.S. Consumer Debt Situation	32
Could the U.S. Subprime Mortgage Crisis Come to Canada?	34
Chapter 4—Canada’s Government Debt	37
Canada’s Debt	38
Accumulated Versus Annual Deficits	40
You Say “Deficit,” I Say “Loss”	40
How Big is Canada’s Debt?	41
Canada’s Annual Deficit History	41
Federal Debt or Accumulated Deficits	42
Future Federal Debt Projections	42
Ratio of Federal Debt to Gross Domestic Product	45
A Word about Provincial and Territorial Accumulated Deficits	46
Canada’s Debt versus the Rest of the World	47
Debt to GDP May be a Misleading Measure	48
MGI’s Five-Part Framework to Assess the Sustainability of Leverage	49
A Personal Health Check	50
A Health Check of Canada	50
One More Measure: Canada’s Debt Per Capita	54
What’s It Like to be Bailed Out	55
Perpetual Government Deficits	56
Is a Foreign Government Default Inevitable?	56
What We Need to Do Now	58
Chapter 5—Canada’s Big Six Chartered Banks	59
Why are They So Worried about Household Debt?	61
An Analysis of the Big Six Canadian Chartered Banks	62
How Much Debt Do the Banks Themselves Have?	66
For A Bank, A Billion Dollar Profit is Peanuts	66
Return On Equity—A Good Measure?	68
What about the Debt-Equity Ratio?	69

CONTENTS

Why Debt is more Popular Than Equity	70
Did Canadian Banks Get a Bailout?	71
CMHC Financial Situation	73
Conclusion	74
Chapter 6—Canadian Household Debt Levels	76
Canadian Average Debt Levels	77
The Line of Credit Trap	79
Been There, Done That	79
Chapter 7—How to Get Out of Personal Debt	81
It's the Principal of the Matter	82
Canadian's Love Affair With Debt	83
The Options to Crush Your Debt	86
Paying Off Your Debts Yourself	86
Are You a Spender or a Saver?	91
Would You Like to Earn \$100 by Staying at Home and Watching TV?	91
Credit Counselling: Debt Management Program (DMP)	92
Shirley's DMP Story	94
Consumer Proposal	97
Bankruptcy	98
Choosing Which Route to Take	102
Chapter 8—Your Credit Score	109
What is a Credit Score?	109
How to Find Out Your Credit Score	109
The Credit Reporting System is not Perfect	111
Your FICO Credit Score	111
What Determines Your FICO Credit Score	112
What Your FICO Score Ignores	115
Individual Credit Ratings	115
Warning: The Following Information Could be Dangerous	116
Credit Score Secrets You Need to Know	117
A Good Credit Score Can Save You Big Money	121
Wrap-Up	121

CONTENTS

Chapter 9—Gaining Control Over Your Money	123
How to Track Your Spending and Find the Fat	123
Analyzing Your Spending Results	132
How Much Do You Make?	134
How Big a Mortgage Could You Get?	135
The Gross Debt Service Ratio (GDS)	135
The Total Debt Service Ratio (TDS)	136
How Much Mortgage Can You Get?	136
The Government Tightens the Insured Mortgage Rules	137
What about Regular Uninsured Mortgages and Other Debt?	139
Conclusion	140
Resources	142
Index	145

ACKNOWLEDGEMENTS

This book required extensive input from experts in the field of debt. Many of these individuals I already knew when I began the book early in 2011, and many I got to know during my research. I am especially grateful to Laurie Campbell, Debbie Dodge, and Phil Brown from Credit Canada, Karen Grant and Tom Higgins from TransUnion, Eric Putnam and Sue Ongaro from Debt Coach Canada, Robert Shier of MNP Ltd., Jay Seaton from Apprisen Financial Advocates, my friends Michel Lambert, Rob Boyd, Jeff Goldberg, David Boese, and Doug Simpson, the people at McKinsey Global Institute, and, of course, Karen Milner, Lucas Wilk, Liz McCurdy and Susan James at my publisher John Wiley & Sons. Last but not least, my literary agent Hilary McMahon of Westwood Creative Artists.

INTRODUCTION

I am going to start with a simple question:

On average, how many times a month do you have sex?

Okay, admittedly that may be a bit of an unusual start to a book on debt.

Let's try this one:

*What is the total balance on your credit cards
and lines of credit?*

The fascinating reality is that I am more likely to get an answer to the first question than the second.

Why?

Because the subject of debt is the biggest taboo there is. Nobody wants to talk about his or her personal debt levels.

Think about it. When was the last time you were at a party and one of your friends openly disclosed that they have a credit card balance they carry from month-to-month?

You are far more likely to have heard someone say, "I pay off my credit card each and every month and never pay any interest!" I hear that all the time.

INTRODUCTION

The problem is that keeping debt issues a secret can be dangerous to your financial health. It is like keeping a cobra in your closet and hoping it doesn't do any damage. That is a recipe for disaster.

We all need to think about and discuss the snake in our closet. If we don't, sooner or later it will strike.

That is what I am attempting to do with this book. I want to bring the subject of debt out of the closet. I am hoping to educate you about all aspects of debt, so that you become comfortable dealing with the subject. Only then will you be able to make financial progress and secure you and your family's financial future.

Don't get scared off. It's honestly not that complicated a subject when you get into it.

So why should you listen to me? Because I want you to get debt-free. I want you to understand why this should be the most important financial goal of your life. And I'm going to tell you the secrets that will allow you to do it.

WHERE I AM COMING FROM

I don't work for a bank. Never have and never will.

I am not sponsored by any financial institution. I don't write content for them, and don't earn any fees of any kind from them. That would probably mean I would have to write what I don't believe in, and if I did that I'd never be able to sleep at night.

I am not a world-renowned economist with complex theories about the inner workings of macro finance, either. As Warren Buffet says, "If something cannot be explained in plain English to me, I don't touch it. Period."

I am not a political animal either. It does not matter to me what political party is in power. I vote for those with a record of making intelligent decisions and who seem to make logical sense with respect to the issues at the time.

The truth of the matter is that it makes no difference to me whether you believe what I say or not. I am not trying to sell you anything.

What I do care about is people. I care about the individual. I care about you and your family. And that is why I wrote this book. I want to tell you the truth as I know it about the debt situation in Canada today.

That includes our government debt, our bank debt, and our individual debt.

What I am about to tell you is based on what my logical mind tells me—the unfiltered truth.

I also don't pretend to know everything. The world's finances can get very complex and you will see in this book that some of it is very difficult to decipher. In some cases it is impossible to find the information easily. That is why I am going to ask for your help.

I am hoping that any reader with something to say on the subject of debt will get in touch with me through my website at www.trahair.com. Just scroll down to the "Contact" button on the left side and it will take you to the page where you can send me an e-mail. Please feel free to straighten me out in areas where you know more than me. Send personal experiences where you think your stories can help others. And make comments about the ever-changing debt issues going forward.

I'd like this to be a living, breathing subject and I'll endeavour to keep my website current with your thoughts and comments.

Drawing people in to discuss the issue of debt is the only way I can think of to get the subject out in the open, where we can analyze it and make sure it doesn't bring financial disaster to us all.

A WORD ABOUT BOOKS

Unfortunately, as soon as you publish a book it can become out of date quite quickly. This book is no exception. While much of what I am about to tell you is timeless advice, some parts of it will become dated very soon. The world and Canada's debt situation is changing at an incredibly rapid pace, so this is unavoidable.

I am hoping that this book will inspire you to keep current on what is going on. To help, as we go along, I will provide the URLs of some of the most useful websites I have visited to gather some of the information and statistics discussed here.

I will also endeavour to highlight the sources that I believe are independent and worth paying attention to.

For example, if you are interested in what is happening in the U.S. with respect to their economic situation, the *New York Times* reporter Thomas L. Friedman is the best I have come across.

INTRODUCTION

In Canada, I have always found Mark Carney, the Governor of the Bank of Canada, to have excellent economic skills and a unique way of cutting through the jargon and explaining complex matters in plain English. Listen carefully to what he says.

THE WORLD IS ON THE EDGE OF A CLIFF

The human race's addiction to debt has led many countries and financial institutions to rack up billions of dollars of debt by spending more than they bring in. Families have also fallen into the trap of adding huge amounts of debt to live beyond their means. Many of us have been living a life we can't afford for decades, and that simply cannot go on forever. Increasing debt at all levels eventually leads to a point where the spending free-for-all comes to an abrupt halt. The debt-fuelled locomotion hits a brick wall.

You may be wondering what government and bank debt has to do with your personal debt. Why should you be concerned about what's going on with the country's finances or the big banks? Because we are all intertwined. What we do as individuals has a direct and significant effect on our banks and our country. Let's look at our banks first.

Our individual debts, the amount we owe on credit cards and lines of credits, are our bank's assets. If we as individuals can't pay back our loans, the bank takes a loss. If enough individuals default on their loans, it can bring down a bank.

We have seen this happen already in the United States.

But before a bank goes under it is likely to be bailed out by the government, right? This has already happened in the U.S. too.

So if our banks' survival is threatened, our federal government will have to step in to bail them out. That would increase the government's own debt level. With big enough numbers it could potentially bankrupt a country.

That almost happened in the U.S. where government debt is out of control. We saw the resulting panic in the days leading up to August 2, 2011 when the U.S. increased its \$14.3 trillion debt ceiling at the last hour to avoid a catastrophic default.

So how we handle our own debt has a direct impact on the bigger picture—our banks and our government.

Introduction

The current debt crisis is also not confined to one country. It has infected dozens of countries all over the world. This is a major problem that is causing major earth-shaking economic and social problems. And Canada is not immune.

Put bluntly, the world's addiction to debt is leading us all straight toward the edge of a debt cliff.

Some countries, financial institutions, and individuals are already falling off. Others will reach that cliff soon. Maybe this year. Maybe next. Or maybe the one after that. But you can be sure about this—a debt-fuelled life will not continue forever. It can't. Sooner or later the debt levels will rise to a breaking point—the point where it becomes impossible to sustain. It will start with not being able to service the debt, meaning not being able to pay the interest on it. The next step is the realization that the debt will never be repaid—ever. Whoever the debt is owed to will be out of luck. They'll be forced to write it off. The creditors—the ones holding the debt—will lose their money.

The truth is that it doesn't really matter what tools the world's economists use. They can play with interest rates all they want. They can grant billion dollar bailouts with money that doesn't exist until the cows come home. That is just delaying the inevitable. In fact, you could make a strong argument that it makes the problem worse.

IT AIN'T GONNA BE EASY, BUT THERE IS HOPE

As you can probably tell, this book is going to be pretty blunt. If you want a feel-good book that says not to worry, the world's debt crisis is overblown, things will work out, put this book down right now.

If you are looking for a book that promises to make you debt-free easily, don't buy this book.

If, however, you want to find out the real truth about what is going on with the world's and Canada's government, bank, and household debt; if you want to find out the secrets the banks and others use to keep you in debt slavery for life; if you want to find out how to get yourself and your family on the right track to crushing your debt: you're holding possibly the best investment you will ever make.

WHY I WROTE THIS BOOK

I had resisted the request to write a book on debt for a long time. Why bother? It's kind of a negative subject and there have been numerous books written on how to get out of debt.

Then I read the headline articles in the *Globe and Mail* on December 13 and 14, 2010, when I was in Ottawa giving courses to fellow CAs on my previous two books.

Here was the heading on December 13:

Ottawa in talks to rein in consumer debt

The article stated that Ottawa was in discussions with the banks about putting new measures into the next federal budget to curb the rise in consumer debt. It quoted the chief executive officer of Canada's largest bank, the Royal Bank of Canada, as not "hitting the panic button yet" over concerns that some consumers may not be able to repay their loans, but that:

"We are clearly at the limit. You don't want significant growth in consumer debt."

The CEO of Canada's biggest bank warning consumers not to bring in any more lucrative personal loan business to his bank? Really? Okay, now I'm interested.

The article went on to describe just how much debt Canadians have. According to the *Globe*, low interest rates had enticed Canadians to borrow at a record pace and many were now finding themselves stretched. The average debt per household, including mortgage and credit card debt, had hit a high of \$96,100. That was in December 2010. It is now over \$100,000.

The next day, the heading was in huge bold letters, the size of the masthead. Here's what the *Globe and Mail* headline said on December 14:

DEBT ALERT

The warning came direct from Mark Carney, Governor of the Bank of Canada. Why was the Bank of Canada warning Canadians to hold back on using their credit cards just before the Christmas season? Doesn't that do the opposite of what is needed to keep the economy going? Isn't consumer spending the key to getting out of the recession and staying out?

The front page noted some sobering statistics:

- Rise in Canadian household debt from a year ago: 6.7 percent
- Drop in average disposable income during third quarter of the year: 1.5 percent

That's the wrong direction in both cases.

The article also noted that, according to Statistics Canada, the average debt-to-income ratio of individual Canadians had reached 148.1 percent, making it higher than that of Americans at 147.2 percent for the first time in a dozen years. This leaves the government with a dilemma: rein in spending and risk hampering the recovery, or do nothing and risk a "cascading financial failure."

Are things really that bad?

Then I read the article. The one statistic that stopped me in my tracks was from TransUnion, one of the two credit bureaus in Canada (the other is Equifax). According to TransUnion, the total active credit population in Canada was 24.8 million consumers. This means they track that number of Canadians who use debt.

These people had an average debt of \$25,163, *excluding* their mortgage.

I said to myself, "Holy . . . Cow. This is serious." And agreed to write this book.

WHAT YOU WILL LEARN

I have always been intrigued by just how many Canadians are in debt, and by how much debt they have. I used to focus on credit card debt. But the credit card issuers don't publish information about the amount

INTRODUCTION

of credit card debt the average customer is saddled with, or the percentage of them that pay the balance off every month. Why would they? It's in their best interest to keep the gravy train of customers paying 20 percent a year on their balances rolling along.

The information from TransUnion was different because it came from an independent source. A source that knows exactly what the balances are for all consumer debt that people owe from all credit card and other sources of consumer debt. That's because it's their job—they track everybody's consumer debt from all sources.

That average debt of \$25,163, means the majority of Canadians are spending much more than they make, and that is a sure-fire recipe for disaster.

We'll delve into personal debt and how to deal with it in a lot more detail in the pages to come.

But we also must put personal debt into perspective since it directly influences bank and government debt. Spending more than we make is great for the banks as we borrow from them and increase their profits as a result. It's also good for the economy as our spending increases the profits of the stores we buy from. And more profits mean more corporate income tax for the government. It also boosts their revenues as more personal income taxes are collected from the salaries of the employees of the successful businesses.

The same goes for governments. As they spend more than they bring in, their economies hum. Social programs go untouched. Taxes don't get raised and in some cases even go lower. Stock and housing prices tend to rise. Everyone is happy.

The problem is: how long can it last? And what happens when the debt limit is reached?

We are finding out. Many governments all over the world are facing the harsh reality that they have been spending way more than they have been bringing in for decades. The resulting multi-billion dollar deficits are frightening.

Greece, Italy, Ireland, Portugal, Spain, the United Kingdom, and the United States. The list of troubled economies goes on and on. Some have received bailouts already, and some will soon have no choice but to ask for one (or for a second or third one).

Introduction

But a government bailout is a last resort. It's what happens when there are no other options. A bailout is not a solution. It is a temporary stopgap measure that delays disaster. But for how long? And will all these bailouts just make matters worse in the long run?

What about Canada? How strong is our country financially?

This book will give you the answers.

What about our financial institutions? Why did none of our big six chartered banks fail, while hundreds of banks around the world did, during the economic meltdown of 2008–2009? Are they as strong as people think they are?

You'll find the answers to these questions here too.

We'll also delve into the subprime mortgage disaster now facing the United States. Can it get that bad in our country? What can we learn from what's going on down south so we can make sure it doesn't happen here?

We will also explore the issue of debt on a personal level. What kinds of debt are there? We'll get into the good, the bad, and the ugly. We'll investigate just how much of the different types of debts Canadians are saddled with, and the alternatives to getting out of debt, including doing it yourself, consumer proposals, and bankruptcy.

Let's begin, shall we?