TD Bank Financial Group

Observation

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TD Economics
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AN UPDATE ON CONSUMER INSOLVENCY

Statistics from the Office of the Superintendent of Bankruptcy (OSB) continue to show a heightened rate of consumer insolvency, consistent with rising unemployment in combination with heightened household debt levels. The 15,465 filings in September represent a seasonally-adjusted annual rate (SAAR) of 6.7 insolvencies per 1,000 persons over 15 years of age (or 0.7%).

Total consumer insolvencies include both consumer bankruptcies, under which the filer must liquidate assets to pay creditors, and consumer proposals, under which a filer's debts are restructured with creditors' assent. Consumer proposals have risen steadily to presently around 20% of all insolvencies, and recent legislative amendments will increase the availability of this route to insolvent consumers.

September's filings raise the number of year-to-date insolvencies to 116,361, or an average annual rate of 0.57%. In an earlier report, we forecasted an average insolvency rate of 0.6% for 2009, equating to around 155,000 insolvencies for the year (see "The Outlook for Consumer Insolvency", May 1, 2009). We believe total insolvencies are still on track with our projection.

Impact of Legislative Changes on Consumer Insolvencies

The number of insolvencies in September was likely biased upwards by various amendments to the Bankruptcy and Insolvency Act (BIA), which came into effect September 18, 2009.

Since certain BIA amendments increased the cost for discharging a bankruptcy, the changes would have induced insolvent individuals to file ahead of the deadline rather than file in late September or October.[1]

So, we regard the jump in September insolvencies as largely the moving forward of future insolvencies because of the amendment's implementation; not new insolvencies, which would not have otherwise been filed. This heightened September pace should then be offset by a lower pace in the coming months.

These BIA amendments also impact the requirements for filing a consumer proposal. By increasing the threshold of liabilities under which a consumer proposal may be filed (now $250,000 from $75,000 previously), the amendments increase the attractiveness of filing a consumer proposal relative to filing bankruptcy. This feature of the amendments should not impact the number of consumer insolvencies, but rather should increase the proportion of consumer proposals. Therefore, this aspect should have no impact on our forecast for overall insolvencies.

1 Specifically, the amendments change the treatment of bankrupt consumers' "surplus income" (earned income in excess of assessed living expenses) that must be contributed to the bankrupt estate (that is, for payment of creditors), extending the time for discharge of bankruptcy for bankrupt consumers with surplus income. For additional details, see: http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02282.html

HIGHLIGHTS

- **15,465 consumer insolvencies are filed in September, representing a seasonally-adjusted annual rate of 6.7 insolvencies per 1,000 persons (over 15 years old).**
- **As a result of the coming-into-effect of legislative amendments, much of this spike in insolvencies during September reflects the moving forward of future insolvency filings.**
- **We project 150,000 to 155,000 consumer insolvency filings for all 2009, equivalent to an insolvency rate of 0.6%.**
- **While rising unemployment is the spark, high household debt relative to personal disposable income appears the kindling for the heightened pace of insolvency.**
- **While we expect the insolvency rate to peak in 2010 and abate thereafter, consistent with falling unemployment, higher insolvency will persist, owing to high household liabilities.**

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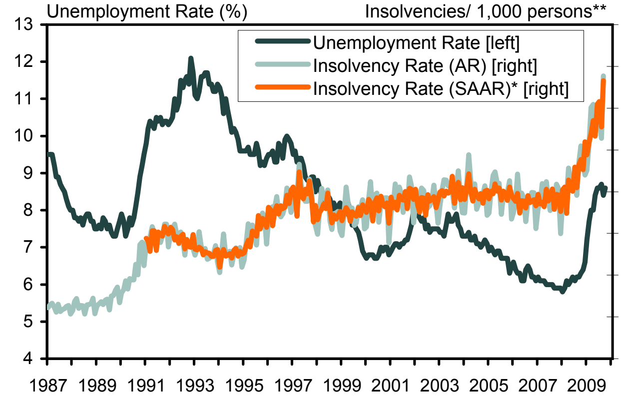
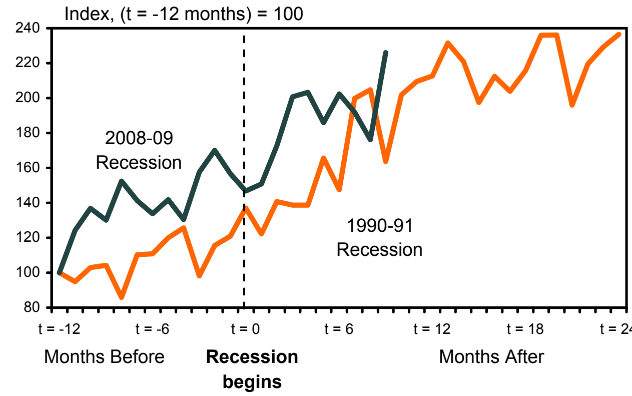


Source: Office of the Superintendent of Bankruptcy, Statistics Canada
* Seasonally-adjusted using StatCan X11 method; ** persons over 15 years old



Source: Office of the Superintendent of Bankruptcy, Statistics Canada
Note: Per persons over 15 years old;

Forecast Volume of Consumer Insolvencies

The September insolvency filings have implications for the insolvency rate during the coming months, but our longer-term outlook for consumer insolvency remains unchanged.

For the near-term, we had previously forecast 150,000 to 160,000 consumer insolvencies during each of 2009 and 2010. Our forecast then corresponds to an average 12,000 consumer insolvencies per month from October to December, compared with the 15,465 in September. This remains reasonable given the anticipated pullback in insolvencies for October and the fact that a lower number of insolvencies are typically filed in December.

For the longer-term, we expect the insolvency rate to peak in 2010 and abate thereafter – albeit gradually. Although unemployment will begin to recede, higher insolvency will persist, owing to protracted joblessness combined with high household liabilities.

We regard unemployment and its persistence as the trigger for higher insolvency. The surge in insolvencies did not occur immediately following the first wave of job losses, but rather lagged the hike in the unemployment rate. This stands to reason: households do not capitulate immediately, but a job loss means that consumers are increasingly unable to maintain payments on debt. The longer that a worker's unemployment lasts, the greater is the probability of insolvency.

The increase in the per capita rate of insolvency has largely tracked its advance in the 1990s. And, consistent with the 1990s experience, as unemployment remains elevated, we expect the rate of per capita insolvency to remain elevated.

Consumer Vulnerabilities Remain

Personal insolvencies have increased sharply during the recession, rising by 45.5% from September 2008 to September 2009 (although this latest month is skewed by the legislative change). Higher unemployment has been the main driver of higher rates of bankruptcies and consumer proposals, and heightened levels of personal indebtedness made households more vulnerable to job loss. Put another way: Layoffs were the spark, but a small portion of households' over-indebtedness was the kindling. Since insolvency tracks the unemployment rate, it is a somewhat lagging indicator and will remain high even as the economy begins to improve. Looking ahead, we anticipate a fairly tepid economic recovery, with the unemployment rate rising into early-2010 and thereafter ebbing only gradually. The insolvency rate should decrease after peaking in 2010, but, similar to unemployment, only abate gradually.