FINANCIAL LITERACY 20- Name ___________ Date _______________

Payday Loan, Bankruptcy...What Should I Do?

Meet Lily. Lily is 25 years old. She graduated college with an Associate's degree in General Business and works full-time as an office assistant. Lily really enjoys the company she works for, so she took a lower-paying position in the hopes of getting promoted in the near future.

She makes a monthly net income of $2,805.92. Lily lives in a small, one-bedroom apartment approximately 20 minutes from her work. Lily overused credit cards while she was attending college and has the following debts:

Debt	Current Balance	Credit Limit	Interest Rate	Minimum Monthly Payment
Credit Card #1	$6,000.00	$6,000.00	18.9%	$180.00
Credit Card #2	$3,855.66	$4,000.00	23.1%	$115.00- 55mos +150-
Credit Card #3	$8,168.40	$8,000.00	18.9%	$245.00
Auto Loan	$15,000.00	n/a	2.9%	$285.00
Student Loan	$11,647.90	n/a	3.76%	$150.00

Exhibit 1

Answer This:

1. What is the total amount of Lily's debt payments each month (assuming she is only making minimum payments)?

$975

2. What percentage of Lily's net income is she spending on debt repayment? A good debt amount is less than 20% of net income.

975/2805.92=.3477*100= 34.7% of net income to debt

3. How do you think Lily's current debts impact her credit score? Explain.

- Overlimit is bad
- # of debt outstanding (types) is bad

Lily's savings habits are far from perfect. She does not pay herself first and very rarely puts money into her savings account. **Currently, she has $79.54 in her account. She lives paycheck to paycheck. Because her salary is lower than she expected, she tries to manage her money each month by keeping a budget.**

Here is a snapshot of Lily's monthly budget:

Exhibit 2

Monthly Budget

Gross Pay	$3,955.27
Federal Income Tax	$519.65
State Income Tax	$166.12
Social Security	$245.23
Medicare	$57.35
Optional Deductions	$161.00
Net Pay	$2,805.92

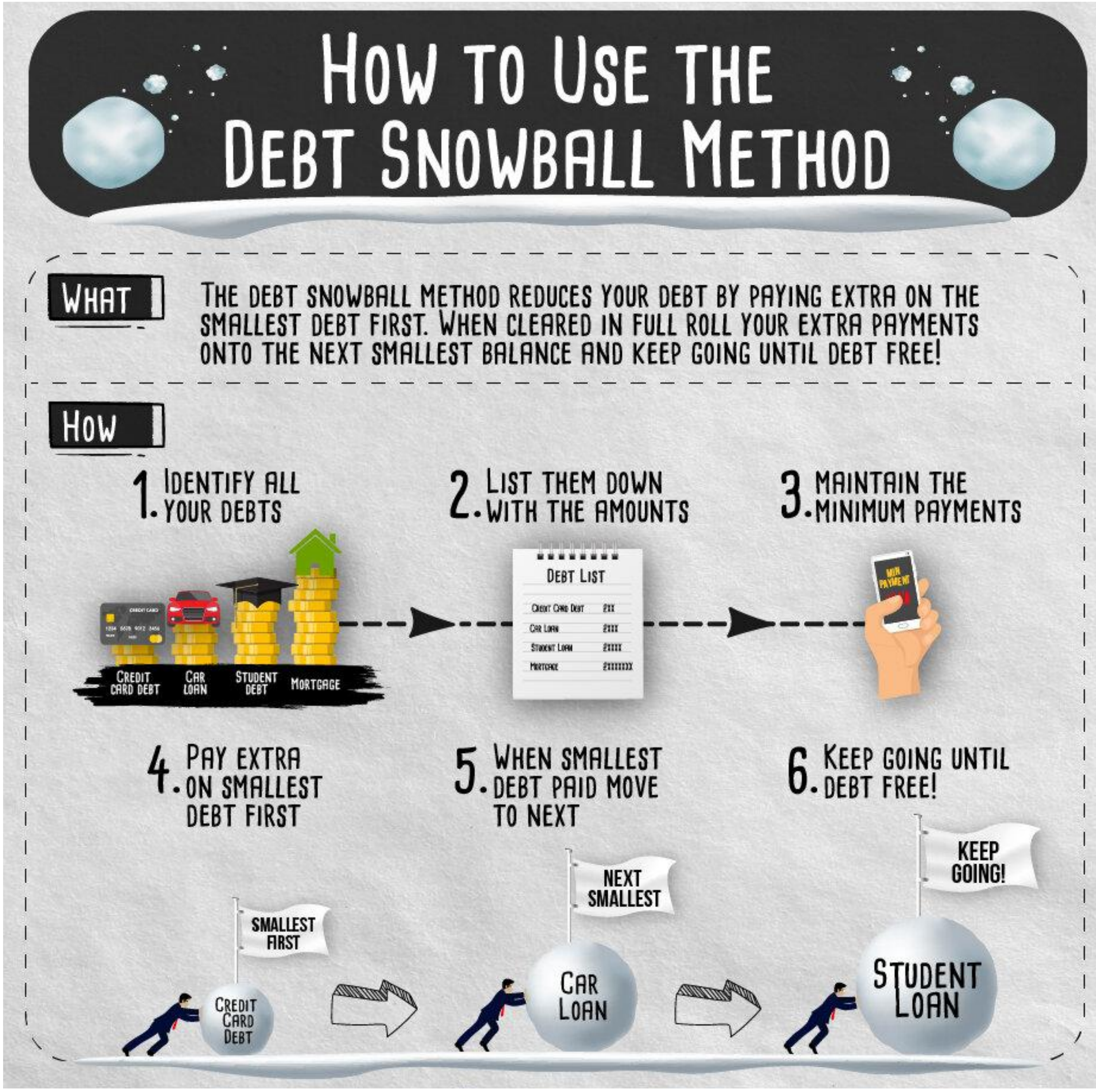
Monthly Expenses

Savings/Debt Payoff		**Transportation**	
Savings Account	$0.00	Car Loan Payment	$285.00
Investments	$0.00	Driver's Insurance	$101.00
Credit Card	$540.00	Gasoline	$95.00
Student Loans	$150.00	Maintenance Expenses	$0.00
		License/Registration Fees	$10.00
Home		Bus/Subway Fares	
Rent/Mortgage	$710.00		
Taxes		**Entertainment**	
Utilities	$155.00	Restaurant Meals	$50.00
Phone Service	$55.00	Event Fees/Tickets	$50.00
Cable TV Service	$60.00	Travel Expenses	
Maintenance Expenses	$20.00		
Insurance	$15.00	**Miscellaneous**	
		Child Care Expenses	
Food/Sundries		Gifts	
Food	$200.00	Donations/Charities	
Personal Care Items	$50.00	Pet/Hobby Expenses	
Small Home Care Items	$50.00	Education Fees	
Personal		**Health Care**	
Clothes	$75.00	Doctor & Dental Fees	$50.00
Haircuts, Manicures		Prescription Medicines	$50.00
Dry Cleaning		Other Insurance (health/life)	
Gym Membership	$25.00		
		Other Expenses	$9.92
		Grand Total	$2,805.92
		(total income = total expenses)	

Answer This:

4. In what areas of Lily's budget do you think she is overspending? Explain.

5. Is there any category that is left out of Lily's budget that should be included?



Lily is wondering about how to pay off her debt and has heard of the **<u>debt snowball method</u>** but wasn't sure she could do it.

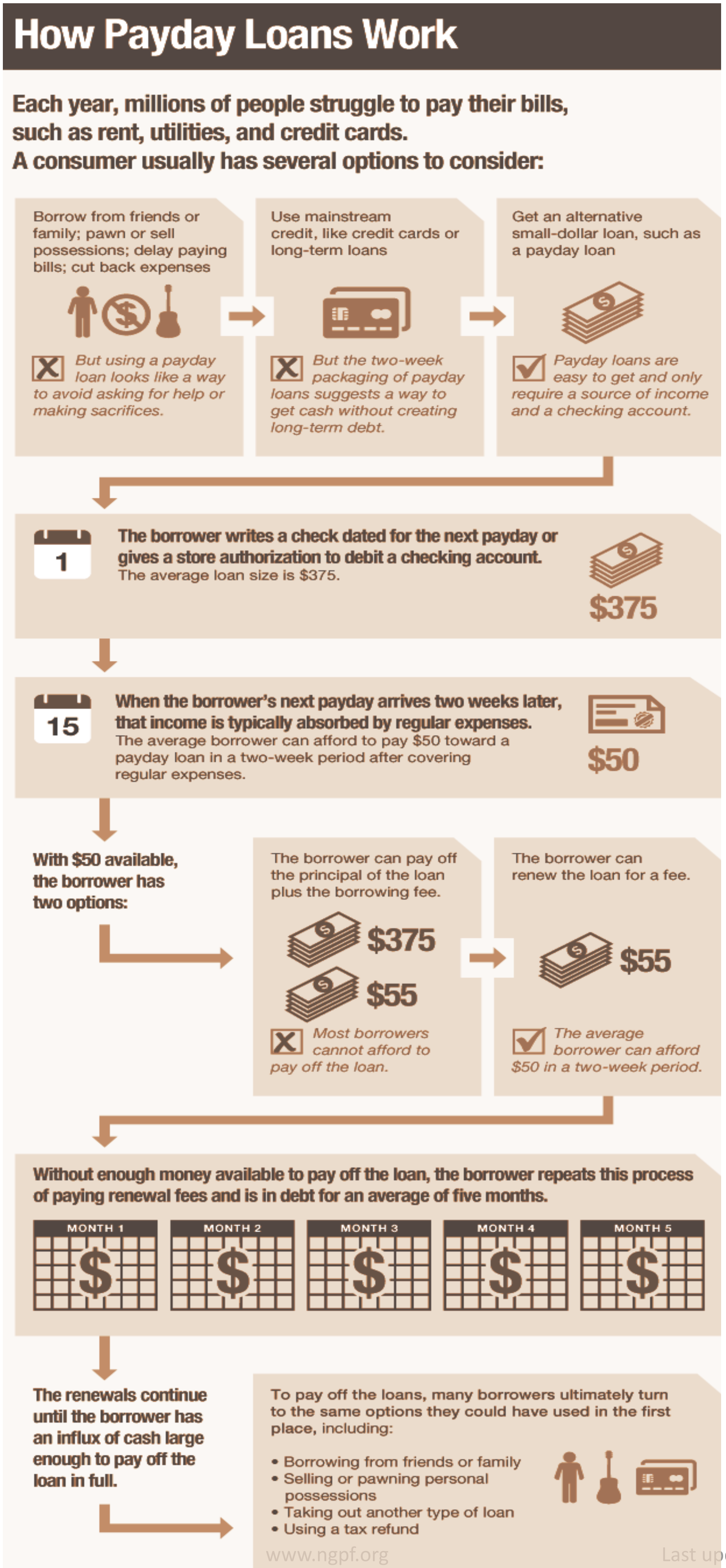
Answer This:

6. If she were to choose this method, which debts would she tackle **first**?

Smallest balance first credit card #2

7. What would be your advice to her to pay down debt using this method?

- Add $150 to c/c #2 and pay $265/mo reduce down to 17 months (from 54
- After 17 months, pay $265 to c/c #1 +180/mo minimum which will be done in 12 months
- Continue to do this on the remaining balances


How Payday Loans Work
Each year, millions of people struggle to pay their bills, such as rent, utilities, and credit cards.
A consumer usually has several options to consider:
Borrow from friends or family; pawn or sell possessions; delay paying bills; cut back expenses
But using a payday loan looks like a way to avoid asking for help or making sacrifices.
Use mainstream credit, like credit cards or long-term loans
But the two-week packaging of payday loans suggests a way to get cash without creating long-term debt.
Get an alternative small-dollar loan, such as a payday loan
Payday loans are easy to get and only require a source of income and a checking account.
1
The borrower writes a check dated for the next payday or gives a store authorization to debit a checking account.
The average loan size is $375.
$375
15
When the borrower's next payday arrives two weeks later, that income is typically absorbed by regular expenses.
The average borrower can afford to pay $50 toward a payday loan in a two-week period after covering regular expenses.
$50
With $50 available, the borrower has two options:
The borrower can pay off the principal of the loan plus the borrowing fee.
$375
$55
Most borrowers cannot afford to pay off the loan.
The borrower can renew the loan for a fee.
$55
The average borrower can afford $50 in a two-week period.
Without enough money available to pay off the loan, the borrower repeats this process of paying renewal fees and is in debt for an average of five months.
MONTH 1
MONTH 2
MONTH 3
MONTH 4
MONTH 5
The renewals continue until the borrower has an influx of cash large enough to pay off the loan in full.
To pay off the loans, many borrowers ultimately turn to the same options they could have used in the first place, including:
• Borrowing from friends or family
• Selling or pawning personal possessions
• Taking out another type of loan
• Using a tax refund

Lily's car has recently broken down and needs a repair. The cost to fix the car totals $500.00. Lily does not have the money available in her savings account and, since her budget is so tight each month, does not know where she can get the funds for this repair. Her credit cards are already maxed out, she does not have enough money in savings, and her only other option would be to not pay her rent that month, but she is already one month behind.

Lily must get her car fixed in order to get to work each day.

Lily decides to visit a local Payday Lender, and they were happy to give her a two-week loan. The Payday Lender is requesting the following information from Lily: a paycheck stub, her next paycheck date, and a current bank statement. She was told that the total fee to borrow the $500.00 would *only* be $75.00, so she would owe $575.00 on her next payday (this lender charges $15.00 for every $100.00 borrowed). All she would have to do is sign some paperwork and bring a post-dated check for her paycheck date to cover the cost of the loan and fee.

Answer This:

8. What would be the financial impact of Lily taking out this Payday Loan? How do borrowers get trapped in an inescapable cycle of borrowing money (every month) when using this type of loan?

Owes $575 next paycheck - where is this going to come from because she does NOT have a surplus right now
If she doesn't pay in FULL, they will charge her $75 in fees every 2 weeks until it's paid IN FULL.
A 2 week loan turns into a 6 month loan and costs her $1500 in the end

Lily is desperate, trapped, and broke. She ended up taking the Payday Loan, and as expected, has renewed the loan five times because, with all of her other monthly bills, does not have the money available to pay it off. She still owes the full amount of her Payday Loan, and her credit card, student loan, and rent are due. She does not have enough money to make ends meet and pay all of these bills.

She is now considering filing for bankruptcy. She feels this is the only way to get out of this cycle of endless, unmanageable debt.

What You Keep & What You Lose
Filing for Bankruptcy in Canada
Keep
Lose
Personal Items
You may keep most worth of personal possessions, like clothing, jewellery, sports equipment, etc.
One Vehicle
You can keep one vehicle up to the provincial limit -- this can be a car, truck or SUV.
Furnishings
Furniture up to a certain dollar value is expempt and this is enough to cover most belongings.
Tools of the Trade
You can keep a specified value of tools necessary for your work.
Life Insurance
Certain types of life insurance are exempt from seizure.
RRSP
These types of savings, except contributions made in the 12 months before your bankruptcy, are exempt.
Equity in House
If your home has equity that is above your province's exemption limit, you must pay the full equity value or you will lose your home.
Other Vehicles
A second vehicle, even if you own it outright, will have to be surrendered or you must pay its full value to your Trustee.
Tax Refund
TAX
You will lose your tax refund for the year of your bankruptcy.
Savings
Any savings in TFSAs, and Savings Bonds can be seized in a bankruptcy. RESPs vary by province.
Credit Rating
Your bankruptcy will affect your credit rating for up to 7 years, at which point you will have to rebuild your credit.
Before considering filing for bankruptcy, ask your trustee about filing a consumer proposal, where you get to keep ALL of your assets.

Bankruptcy

Bankruptcy is a legal process designed to relieve honest but unfortunate debtors of their debts.

At the end of the process, the bankrupt is released from the obligation to repay the debts they had when the bankruptcy was filed (with some exceptions).

Proposal

A proposal is an offer to creditors to pay a percentage of what is owed over a specific period of time, or to extend the amount of time to pay off the debt, or a combination of both. Creditors vote to accept or reject the proposal.

There are two types of proposals:

- **Consumer proposals**—available to individuals who owe less than $250,000, excluding mortgages; and
- **Division I proposals**—available to businesses and individuals (there is no limit regarding how much money is owed).

Once all the terms of the proposal are met, the debtor is legally released from the debts included in the proposal.

The Main Stakeholders

Debtor (owes money)

A **debtor** is an insolvent person who is unable to pay their debts when they are due. A **bankrupt** is a debtor who has filed for bankruptcy.

Responsibilities

The debtor must:

- attend two financial counselling sessions; and
- assist the Licensed Insolvency Trustee (LIT) in administering the bankruptcy or proposal.

In addition, the bankrupt must:

- disclose all of their assets (property) and debts to the LIT;
- advise the LIT of any property disposed of in the past few years; and
- surrender all credit cards to the LIT.

Creditors (are owed money)

There are three main types of creditors: secured, unsecured and preferred.

Responsibilities

The role of creditors is to:

- participate in and vote at meetings of creditors;
- appoint inspectors;
- serve as an inspector; and
- inform the LIT of any irregularities on the part of the debtor.

Licensed Insolvency Trustee (LIT)

LIT are licensed by the OSB and are officers of the court.

Responsibilities

The LIT:

- administers proposals and bankruptcies;
- protects the rights of creditors;
- investigates the affairs of the debtor; and
- ensures the rights of the debtor are not abused.

9. What are the key differences between bankruptcy and consumer proposal?

B- lose assets; CP- keep assets
B- Ruin credit for up to 7 years; CP- maintain credit (somewhat bad)
B- credit gone; CP - keep credit open
B- debt is written off (banks take the loss); CP- debt is eventually paid (over time)

10. How will filing bankruptcy or a consumer proposal impact Lily's ability to use and obtain credit in the future?

B- no loans, credit cards, utilities (power), cell phone contracts all gone

CP- can keep some credit available and fix it over time

11. Lily is unsure what to do. In the space below, draft an email to Lily about the consequences of filing for bankruptcy and your financial advice. Although she is overwhelmed with debt, she must understand the long-term consequences of filing for bankruptcy and the importance of paying off her Payday Loan. In your email, include:

- Your financial advice to Lily.
    - Are there changes she could make to her lifestyle or budget?
    - Is bankruptcy the best decision?
    - How else can she pay off the Payday Loan and other debts?
    - Could she use a debt strategy such as the Debt Snowball or High Rate?
    - What long-term consequences should she consider before making a decision?
    - What advice would you give her? What should she do?

To: Lily
Subject: