be resilient.

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Personal debt management

Debt impacts more than just your wallet and ability to buy necessities. It can also have negative effects on your mental, emotional and physical health. If you've taken on too much debt, it's important to tackle it head on and try to manage it, so it doesn't continue to overwhelm you.

How much debt is too much?

The amount of debt you feel comfortable with is based on your personal tolerance. Some people are overly cautious about debt. Others are maybe too cavalier about the amount of debt they have. Beyond personal comfort levels, how much debt is too much?

One calculation that many financial advisors follow is the 50-30-20 rule. This breaks down your expenses into three groups: needs (50 per cent of your income), wants (30 per cent) and savings (20 per cent). Your needs are defined as payments of debt including mortgage and credit card payments, as well as any other essentials you need to live, such as food and utilities. The 30 per cent for wants are things like vacations, extracurricular activities for children and gifts. The remaining 20 per cent is for your retirement and other long-term savings.

If more than 50 per cent of your monthly payments are going towards needs, this is a disproportionate amount that is unsustainable.

Another standard calculation from the financial industry is called the total debt service (TDS) ratio. It is similar to the 50-30-20 rule but goes directly to the issue of debt service. This standard suggests that no more than 44 per cent of your monthly income goes to debt servicing, plus utilities and property taxes. This formula differs from the 50-30-20 rule by excluding food.

If more than 44 per cent of your monthly income goes to debt service, utilities and property taxes, it is not sustainable.

How to reduce debt?

So now that we know how much is too much, what do you do if your debt levels are too high? The most direct way is to pay off the debt. This usually requires redistributing money from other areas (your wants and savings) and paying off the debt to a manageable level.

Alternatively, you can use other lower interest debt, such as a line of credit, to help pay off higher-interest credit card debt. Keep in mind that you will still have to pay off the line of credit, so you will need to include the additional line of credit payments into your overall financial plan.

You can also contact your creditors (i.e. the credit card company, bank, etc.) to see if special arrangements can be made to help reduce your monthly payments or interest rate. This may help bring your monthly payments back into line with the 50-30-20 or TDS rules.

Which debt to pay off first?

When you pay off debt, focus on the highest interest debt first, such as credit card debt. Mortgage interest and line of credit interest should be a lower priority, as it usually has a lower rate of interest.

One exception to this rule is if your credit card is being used for business and can be deducted for tax purposes. Then, it is usually best not to pay off that debt until your non-deductible debt is paid first.

What if none of these strategies will work?

If the situation is more serious and none of these strategies work, you may have to investigate a more intensive strategy. This usually involves engaging a third party, such as a credit counsellor or a licensed insolvency trustee (LIT) to discuss your options, which include:

A debt settlement program. This often involves a third party who will negotiate on your behalf. Usually, this includes a debt settlement that requires the person in debt to sell an asset for less than its full value to pay off the debt.

A debt management program. This is a formal program but is not registered. It is usually administered by a credit counselling service. All unsecured debts are consolidated into one payment to the credit counselling service, usually at a much lower interest rate. The program is not part of the public record and after two years, all records are erased from your credit history, so your credit score is not negatively impacted

A consumer proposal. This is a formal process, but it is less serious than bankruptcy. It can be considered if you owe more than $1,000 but less than $250,000 in unsecured debt. (This would exclude your mortgage, as it is secured debt.) This is a legal process and is usually administered by an LIT. Consumer proposals stay on your credit history for three years. LITs charge for this service. It is less serious than bankruptcy, but it can cost more than bankruptcy.

Bankruptcy. This is also a formal process, which uses an LIT. It is a fresh start and may be less expensive than a consumer proposal and may be the only option for some. It is the most serious method though. It must be approved by the courts, you may need to sell some assets and it does not apply to secured debt, such as a mortgage. It can also affect some professional licences, and it is part of your credit history for seven years.

Debt and the burdens it can bring can have a severe impact on day-to-day life, relationships and health. Getting support to address the practical and emotional aspects of debt and creating a practical and comprehensive solution can reduce the strain and lead you on a path of recovery.

- Mark Binder, Chartered Professional Accountant

For more information call the Employee Assistance Centre at 204.786.8880 or toll-free 1.800.590.5553 or visit mb.bluecross.ca. For the Deaf, hard-of-hearing and speech-impaired community, our EA centre can receive VRS calls.

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