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## What happens to bondholders when a company goes bankrupt?

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Seniors like bonds because they can possibly provide a steady income, diversify a stock portfolio and are backed by the insurer's financial strength. But things don't always go as planned. Companies occasionally have financial problems and must file for bankruptcy.

Investors holding bonds in bankrupt companies can at least have the comfort in knowing that as unsecured creditors they are second in line for payment. Secured creditors, those with claims backed by collateral such as equipment or real estate, are paid first. Stockholders come last. And that is only if there is any money left after the creditors have been paid.

There are two general forms of bankruptcy: Chapter 7 and Chapter 11.

With Chapter 7, the company is liquidated and bondholders should file a claim to receive a portion of the value of their bonds.

In Chapter 11 proceedings, however, the process is quite different. Chapter 11 allows the corporation to reorganize. Its bonds might continue to trade, but holders will not receive principal and interest payments. As a result, a default could occur, and the value of the bonds might decline significantly. Or the court may approve an exchange of the old bonds for new ones, which could have a lower value.

How can you find out if a company that you lent money to by purchasing a bond has filed for bankruptcy? TV reports, newspapers, and financial magazines often give an account of companies that recently declared bankruptcy. The company will also send you information on the reorganization plan and ask you to vote on it. And if a financial institution holds the bond for you, it should forward everything from the company.

Warren W. Wall CFP, CSA is a local financial author and advisor with W. Wall & Company, Inc. a Registered Investment Advisor. For contact and free investment workshop information, visit [www.Wallco.com](http://www.Wallco.com) or call 651-9617.

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