

**THE CHALLENGE**

*Emily is 28 years old with \$35,500 in debt: \$8,500 on Credit Card A (22% APR), \$6,200 on Credit Card B (19.5% APR), \$5,000 personal loan (12% APR), \$3,800 in medical bills (in collections), and \$12,000 on a car loan (6.5% APR). Her monthly income is \$3,200, with \$2,400 in essential expenses, leaving \$800 discretionary. Her credit score is 580. What debt management strategy should she pursue?*

**How do you determine the best strategy for managing overwhelming debt, and when might bankruptcy be the right choice?**

**Learning Objectives**

- Identify strategies for managing high levels of debt.
- Compare advantages and disadvantages of debt management options.
- Recognize long-term effects of bankruptcy on personal finances.
- Explore alternatives to bankruptcy.
- Develop strategies for rebuilding credit after financial setbacks.

**CORE CONCEPTS**

| Term                  | Definition   |
|-----------------------|--|
| Debt Management Plan  | A structured repayment plan arranged by a credit counseling agency; typically 3-5 years.           |
| Debt Consolidation    | Combining multiple debts into one loan to simplify payments and potentially reduce interest rates. |
| Debt Settlement       | Negotiating with creditors to pay less than the full amount owed; may have tax implications.       |
| Chapter 7 Bankruptcy  | Liquidation bankruptcy: most debts discharged in 3-6 months; stays on credit report 10 years.      |
| Chapter 13 Bankruptcy | Reorganization bankruptcy: 3-5 year repayment plan; keeps assets; on credit report 7 years.        |
| Secured Credit Card   | A credit card requiring a deposit; used to rebuild credit after financial setbacks.                |

**Background:** When debt becomes overwhelming, several strategies can help: debt management plans work with creditors to lower rates, debt consolidation combines debts into one payment, debt settlement negotiates paying less than owed, and bankruptcy provides legal protection to discharge or restructure debt. The best strategy depends on debt type, income, assets, and long-term goals. After any debt crisis, rebuilding credit requires patience and consistent positive financial behaviors.

## APPLY IT

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### PART A: DEBT STRATEGY COMPARISON

Compare debt management strategies to understand when each is most appropriate.

| Strategy              | Best For  | Credit Impact            | Timeframe  |
|-----------------------|---|--------------------------|------------|
| Debt Management Plan  | Unsecured debt (credit cards), steady income        | Moderate negative        | 3-5 years  |
| Debt Consolidation    | Good credit, multiple high-interest debts           | Minimal if payments made | 3-7 years  |
| Debt Settlement       | Lump sum available, willing to accept credit damage | Significant negative     | 1-3 years  |
| Chapter 7 Bankruptcy  | Low income, few assets, overwhelming debt           | Severe (10 years)        | 3-6 months |
| Chapter 13 Bankruptcy | Regular income, want to keep assets                 | Severe (7 years)         | 3-5 years  |

- Based on Emily's situation from The Challenge, which strategy would you recommend and why?
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### PART B: DEBT PRIORITIZATION ANALYSIS

List Emily's debts and determine a payment priority order.

| Debt          | Balance | Interest Rate | Minimum Payment | Priority Rank (1-5) |
|---------------|---------|---------------|-----------------|---------------------|
| Credit Card A | \$8,500 | 22%           | \$170           |                     |
| Credit Card B | \$6,200 | 19.5%         | \$124           |                     |
| Personal Loan | \$5,000 | 12%           | \$150           |                     |
| Medical Bills | \$3,800 | 0%            | In Collections  |                     |

|          |          |      |       |  |
|----------|----------|------|-------|--|
| Car Loan | \$12,000 | 6.5% | \$240 |  |
|----------|----------|------|-------|--|

**2.** Explain your prioritization. Should Emily use the "avalanche method" (highest interest first) or "snowball method" (smallest balance first)?

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**Hint:** Avalanche method saves more on interest; snowball method provides psychological wins. Either works if you stick with it.

### PART C: CREDIT REBUILDING PLAN

Outline steps to rebuild credit after resolving debt problems.

**3.** List FOUR strategies for rebuilding credit after bankruptcy or debt settlement.

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### CHECK YOUR UNDERSTANDING

**1.** What is the main difference between Chapter 7 and Chapter 13 bankruptcy?

- A. Chapter 7 has more impact on credit than Chapter 13
- B. Chapter 7 liquidates assets; Chapter 13 creates a repayment plan
- C. Chapter 7 takes longer to complete than Chapter 13
- D. Chapter 7 is only for business debt; Chapter 13 is for personal debt

**2.** Why might forgiven debt in a debt settlement have tax implications?

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**3. Calculation:** Maria settled \$30,000 in debt for \$18,000. The forgiven amount is taxable income. If she's in the 22% tax bracket, how much additional tax will she owe?

Show your work:

Additional tax owed: \$\_\_\_\_\_

**4.** What is a secured credit card, and how does it help rebuild credit?

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**5. Reflection:** If a friend asked whether they should file for bankruptcy to clear \$25,000 in credit card debt, what questions would you ask them before giving advice?

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