

# Coping With Debt





Having trouble paying your bills? Getting dunning notices from creditors? Are your accounts being turned over to debt collectors? Are you worried about losing your home or your car?

You're not alone. Many people face a financial crisis at some point in their lives. Whether the crisis is caused by personal or family illness, the loss of a job, or overspending, it can seem overwhelming. But often, it can be overcome. Your financial situation doesn't have to go from bad to worse.

If you or someone you know is in financial hot water, consider these options: **self-help** using realistic budgeting and other techniques; **debt relief services**, like credit counseling or debt settlement from a reputable organization; **debt consolidation**; or **bankruptcy**. How do you know which will work best for you? It depends on your level of debt, your level of discipline, and your prospects for the future.

## Self-Help

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### Developing a Budget

The first step toward taking control of your financial situation is to do a realistic assessment of how much money you take in and how much money you spend. Start by listing your income from all sources. Then, list your “fixed” expenses – those that are the same each month – like mortgage payments or rent, car payments, and insurance premiums. Next, list the expenses that vary – like groceries, entertainment, and clothing. Writing down all your expenses, even those that seem insignificant, is a helpful way to track your spending patterns, identify

necessary expenses, and prioritize the rest. The goal is to make sure you can make ends meet on the basics: housing, food, health care, insurance, and education. You can find information about budgeting and money management techniques online, at your public library, and in bookstores. Computer software programs can be useful tools for developing and maintaining a budget, balancing your checkbook, and creating plans to save money and pay down your debt.

## Contacting Your Creditors

Contact your creditors immediately if you're having trouble making ends meet. Tell them why it's difficult for you, and try to work out a modified payment plan that reduces your payments to a more manageable level. Don't wait until your accounts have been turned over to a debt collector. At that point, your creditors have given up on you.

## Dealing with Debt Collectors

Federal law dictates how and when a debt collector may contact you: not before 8 a.m., after 9 p.m., or while you're at work if the collector knows that your employer doesn't approve of the calls. Collectors may not harass you, lie, or use unfair practices when they try to collect a debt. And they must honor a written request from you to stop further contact.

## Managing Your Auto and Home Loans

Your debts can be unsecured or secured. Secured debts usually are tied to an asset, like your car for a car loan, or your house for a mortgage. If you stop making payments, lenders can repossess your car or foreclose on your house. Unsecured debts are not tied to any particular asset, and

include most credit card debt, bills for medical care, and signature loans.

Most automobile financing agreements allow a creditor to repossess your car any time you're in default. No notice is required. If your car is repossessed, you may have to pay the balance due on the loan, as well as towing and storage costs, to get it back. If you can't do this, the creditor may sell the car. If you see default approaching, you may be better off selling the car yourself and paying off the debt: You'll avoid the added costs of repossession and a negative entry on your credit report.

If you fall behind on your mortgage, contact your lender immediately to avoid foreclosure. Most lenders are willing to work with you if they believe you're acting in good faith and the situation is temporary. Some lenders may reduce or suspend your payments for a short time. When you resume regular payments, though, you may have to pay an additional amount toward the past due total. Other lenders may agree to change the terms of the mortgage by extending the repayment period to reduce the monthly debt. Ask whether additional fees would be assessed for these changes, and calculate how much they total in the long term.

If you and your lender can't work out a plan, contact a housing counseling agency. Some agencies limit their counseling services to homeowners with FHA mortgages, but many offer free help to any homeowner who's having trouble making mortgage payments. Call the local office of the Department of Housing and Urban Development or the housing authority in your state, city, or county for help in finding a legitimate housing counseling agency near you.

## **Debt Relief Services**

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If you're struggling with significant credit card debt, and can't work out a repayment plan with your creditors on your own, consider contacting a debt relief service like credit counseling or debt settlement. Depending on the type of service, you might get advice on how to deal with your mounting bills or create a plan for repaying your creditors.

Before you do business with any debt relief service, check it out with your state Attorney General and local consumer protection agency. They can tell you if any consumer complaints are on file about the firm you're considering doing business with. Ask your state Attorney General if the company is required to be licensed to work in your state and, if so, whether it is.

If you're thinking about getting help to stabilize your financial situation, do some homework first. Find out what services a business provides, how much it costs, and how long it may take to get the results they promised. Don't rely on verbal promises. Get everything in writing, and read your contracts carefully.

## **Credit Counseling**

Reputable credit counseling organizations can advise you on managing your money and debts, help you develop a budget, and offer free educational materials and workshops. Their counselors are certified and trained in consumer credit, money and debt management, and budgeting. Counselors discuss your entire financial situation with you, and help you develop a personalized plan to solve your money problems. An initial counseling

session typically lasts an hour, with an offer of follow-up sessions.

Most reputable credit counselors are non-profits and offer services through local offices, online, or on the phone. If possible, find an organization that offers in-person counseling. Many universities, military bases, credit unions, housing authorities, and branches of the U.S. Cooperative Extension Service operate non-profit credit counseling programs. Your financial institution, local consumer protection agency, and friends and family also may be good sources of information and referrals.

But be aware that “non-profit” status doesn’t guarantee that services are free, affordable, or even legitimate. In fact, some credit counseling organizations charge high fees, which they hide, or urge their clients to make “voluntary” contributions that can cause more debt.

## **Debt Management Plans**

If your financial problems stem from too much debt or your inability to repay your debts, a credit counseling agency may recommend that you enroll in a debt management plan (DMP). A DMP alone is not credit counseling, and DMPs are not for everyone. Don’t sign up for one of these plans unless and until a certified credit counselor has spent time thoroughly reviewing your financial situation, and has offered you customized advice on managing your money. Even if a DMP is appropriate for you, a reputable credit counseling organization still can help you create a budget and teach you money management skills.

In a DMP, you deposit money each month with the credit counseling organization. It uses your deposits to pay your

unsecured debts, like your credit card bills, student loans, and medical bills, according to a payment schedule the counselor develops with you and your creditors. Your creditors may agree to lower your interest rates or waive certain fees. But it's a good idea to check with all your creditors to be sure they offer the concessions that a credit counseling organization describes to you. A successful DMP requires you to make regular, timely payments; it could take 48 months or more to complete your DMP. Ask the credit counselor to estimate how long it will take for you to complete the plan. You may have to agree not to apply for – or use – any additional credit while you're participating in the plan.

## **Debt Settlement Programs**

Debt settlement programs typically are offered by for-profit companies, and involve them negotiating with your creditors to allow you to pay a “settlement” to resolve your debt – a lump sum that is less than the full amount that you owe. To make that lump sum payment, the program asks that you set aside a specific amount of money every month in savings. Debt settlement companies usually ask that you transfer this amount every month into an escrow-like account to accumulate enough savings to pay off any settlement that is eventually reached. Further, these programs often encourage or instruct their clients to stop making any monthly payments to their creditors.

## **Debt Settlement Has Risks**

Although a debt settlement company may be able to settle one or more of your debts, there are risks associated with these programs to consider before enrolling:

1. These programs often require that you deposit money in a special savings account for 36 months

or more before all your debts will be settled. Many people have trouble making these payments long enough to get all (or even some) of their debts settled, and end up dropping out the programs as a result. Before you sign up for a debt settlement program, review your budget carefully to make sure you are financially capable of setting aside the required monthly amounts for the full length of the program.

2. Your creditors have no obligation to agree to negotiate a settlement of the amount you owe. So there is a possibility that your debt settlement company will not be able to settle some of your debts – even if you set aside the monthly amounts required by the program. Also, debt settlement companies often try to negotiate smaller debts first, leaving interest and fees on large debts to continue to mount.
3. Because debt settlement programs often ask or encourage you to stop sending payments directly to your creditors, they may have a negative impact on your credit report and other serious consequences. For example, your debts may continue to accrue late fees and penalties that can put you further in the hole. You also may get calls from your creditors or debt collectors requesting repayment. You could even be sued for repayment. In some instances, when creditors win a lawsuit, they have the right to garnish your wages or put a lien on your home.

## **Debt Settlement and Debt Elimination Scams**

Some companies offering debt settlement programs may not deliver on their promises, like their “guarantees” to settle all your credit card debts for 30 to 60 percent of the amount you owe. Other companies may try to collect their fees from you before they settle any of your debts. The FTC’s Telemarketing Sales Rule prohibits companies that sell debt settlement and other debt relief services on the phone from charging a fee before they settle or reduce your debt. Some companies may not explain the risks associated with their programs, including that many (or most) of their clients drop out without settling their debts, that their clients’ credit reports may suffer, or that debt collectors may continue to call them.

Before you enroll in a debt settlement program, do your homework. You’re making a big decision that involves spending a lot of your money that could go toward paying down your debt. Enter the name of the company with the word “complaints” into a search engine. Read what others have said about the companies you’re considering, including whether they are involved in a lawsuit with any state or federal regulators for engaging in deceptive or unfair practices.

### **Fees**

If you do business with a debt settlement company, you may have to put money in a dedicated bank account, which will be administered by an independent third party.

The funds are yours and you are entitled to the interest that accrues. The account administrator may charge you a reasonable fee for account maintenance, and is responsible for transferring funds from your account to pay your creditors and the debt settlement company when settlements occur.

## Disclosure Requirements

Before you sign up for the service, the debt relief company must give you information about the program:

- **Price and terms.** The company must explain its fees and any conditions on its services.
- **Results.** The company must tell you how long it will take to get results – how many months or years before it will make an offer to each creditor for a settlement.
- **Offers.** The company must tell you how much money or what percentage of each outstanding debt you must save before it will make an offer to each creditor on your behalf.
- **Non-payment.** If the company asks you to stop making payments to your creditors – or if the program relies on your not making payments – it must tell you about the possible negative consequences of your action.

The debt relief company also must tell you:

- that the funds are yours and you are entitled to the interest earned;

- the account administrator is not affiliated with the debt relief provider and doesn't get referral fees; and
- that you may withdraw your money at any time without penalty.

## Tax Consequences

Depending on your financial condition, any savings you get from debt relief services can be considered income and taxable. Credit card companies and others may report settled debt to the IRS, which the IRS considers income, unless you are “insolvent.” Insolvency is when your total debts are more than the fair market value of your total assets. Insolvency can be complex to determine. Talk to a tax professional if you are not sure whether you qualify for this exception.

## Use Caution When Shopping for Debt Relief Services

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Avoid any debt relief organization – whether it's credit counseling, debt settlement, or any other service – that:

- △ charges any fees before it settles your debts or enters you into a DMP
- △ pressures you to make “voluntary contributions,” which is really another name for fees
- △ touts a “new government program” to bail out personal credit card debt
- △ guarantees it can make your unsecured debt go away

- △ tells you to stop communicating with your creditors, but doesn't explain the serious consequences
- △ tells you it can stop all debt collection calls and lawsuits
- △ guarantees that your unsecured debts can be paid off for pennies on the dollar
- △ won't send you free information about the services it provides without requiring you to provide personal financial information, like your credit card account numbers, and balances
- △ tries to enroll you in a debt relief program without reviewing your financial situation with you
- △ offers to enroll you in a DMP without teaching you budgeting and money management skills
- △ demands that you make payments into a DMP before your creditors have accepted you into the program

## Debt Consolidation

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You may be able to lower your cost of credit by consolidating your debt through a second mortgage or a home equity line of credit. But these loans require you to put up your home as collateral. If you can't make the payments – or if your payments are late – you could lose your home.

What's more, consolidation loans have costs. In addition to interest, you may have to pay "points," with one point equal to one percent of the amount you borrow. Still,

these loans may provide certain tax advantages that are not available with other kinds of credit.

## Bankruptcy

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Personal bankruptcy also may be an option, although its consequences are long-lasting and far-reaching. People who follow the bankruptcy rules receive a discharge – a court order that says they don't have to repay certain debts. However, bankruptcy information (both the date of the filing and the later date of discharge) stay on a credit report for 10 years and can make it difficult to get credit, buy a home, get life insurance, or sometimes get a job. Still, bankruptcy is a legal procedure that offers a fresh start for people who have gotten into financial difficulty and can't satisfy their debts.

There are two main types of personal bankruptcy: Chapter 13 and Chapter 7. Each must be filed in federal bankruptcy court. Filing fees are several hundred dollars. For more information visit [www.uscourts.gov/bankruptcycourts/fees.html](http://www.uscourts.gov/bankruptcycourts/fees.html). Attorney fees are extra and vary.

Chapter 13 allows people with a steady income to keep property, like a mortgaged house or a car, that they might otherwise lose through the bankruptcy process. In Chapter 13, the court approves a repayment plan that allows you to use your future income to pay off your debts during three to five years, rather than surrender any property. After you make all the payments under the plan, you receive a discharge of your debts.

Chapter 7 is known as straight bankruptcy; it involves liquidating all assets that are not exempt. Exempt property may include automobiles, work-related tools, and basic household furnishings. Some of your property may be sold by a court-appointed official, called a trustee, or turned over to your creditors.

Both types of bankruptcy may get rid of unsecured debts and stop foreclosures, repossessions, garnishments and utility shut-offs, as well as debt collection activities. Both also provide exemptions that let you keep certain assets, although exemption amounts vary by state. Personal bankruptcy usually does not erase child support, alimony, fines, taxes, and some student loan obligations. And, unless you have an acceptable plan to catch up on your debt under Chapter 13, bankruptcy usually does not allow you to keep property when your creditor has an unpaid mortgage or security lien on it.

You must get credit counseling from a government-approved organization within six months *before* you file for any bankruptcy relief. You can find a state-by-state list of government-approved organizations at [www.usdoj.gov/ust](http://www.usdoj.gov/ust). That's the website of the U.S. Trustee Program, the organization within the U.S. Department of Justice that supervises bankruptcy cases and trustees. Also, before you file a Chapter 7 bankruptcy case, you must satisfy a "means test." This test requires you to confirm that your income does not exceed a certain amount. The amount varies by state and is publicized by the U.S. Trustee Program at [www.usdoj.gov/ust](http://www.usdoj.gov/ust).

## Debt Scams

**Advance Fee Loans:** Some companies guarantee you a loan if you pay them a fee in advance. The fee may range from \$100 to several hundred dollars. Resist the temptation to follow up on these advance-fee loan guarantees. They may be illegal. It's true that many legitimate creditors offer extensions of credit through telemarketing and require an application or appraisal fee in advance. But legitimate creditors never **guarantee** that you will get the loan – or even represent that a loan is likely. Under the FTC's Telemarketing Sales Rule, a seller or telemarketer who guarantees or represents a high likelihood of your getting a loan or some other extension of credit may not ask for – or accept – payment until you get the loan.

**Credit Repair:** Be suspicious of claims from so-called credit repair clinics. Many companies appeal to people with poor credit histories, promising to clean up their credit reports for a fee. But anything these companies can do for you for a fee, you can do yourself – for free. You have the right to correct inaccurate information in your file, but no one – regardless of their claims – can remove accurate negative information from your credit report. Only time and a conscientious effort to repay your debts will improve your credit report. Federal – and some state – laws ban these companies from charging you a fee until the services are fully performed.

The FTC works to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint or get free information on consumer issues, visit [ftc.gov](http://ftc.gov) or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. Watch a video, *How to File a Complaint*, at [ftc.gov/video](http://ftc.gov/video) to learn more. The FTC enters consumer complaints into the Consumer Sentinel Network, a secure online database and investigative tool used by hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.









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