



Questions to Ask When Considering Debt Settlement

Consumers in financial distress are often focused on one thing—relief. After all, the mailbox is full of collection letters, and the answering machine is filled with calls from those you owe. Money is tight and it seems as though there's no way out. When you are at your lowest, you hear a commercial that says you can be debt free in a matter of months. The offer that sounds so tempting may be from a debt settlement company. Is it too good to be true, or a real way out?

The National Foundation for Credit Counseling (NFCC) suggests that consumers consider the following and ask the right questions when considering using a debt settlement company:

- **What is debt settlement?** Debt settlement can also be known by other names such as debt arbitration or debt negotiation. It is a process through which your creditor accepts less than the full amount owed, yet considers the balance as paid. Settlement companies often advertise that they can save you 50 percent or more of what you owe, with repayment typically taking between two and four years.
- **If I don't have the money to repay my debts, where does the money come from for the settlement?** A settlement company may suggest that you stop paying your creditors and instead begin making deposits into a special third-party account. The settlement company will attempt to negotiate a settlement offer with your creditor once enough money relative to the debt is on deposit. This may take six months or more, although the exact length of time will vary with circumstances. During this time, the balance on your account can continue to grow if interest and various penalty fees continue to be charged by your creditor. As a result, you may owe more than when you started and your credit may suffer because of your failure to make any payments on your debt. Even worse, legal actions such as wage garnishment or a judgment may be filed against you during this time.
- **How is settlement reported on my credit report?** Debts paid off as part of a negotiated settlement will generally show "Paid by Settlement" on a consumer's credit report. If you later apply for new loans, the prospective lender(s) will understand that a debt paid by settlement means that your repayment did not cover the total debt that you had accumulated, but that your creditor accepted a lesser amount.
- **What happens to my credit score?** Your credit score is based on information contained in your credit report, with the highest consideration given to how you repay your debts. As stated above, if you're not repaying the creditor or have missed payments, it will show on your credit report and potentially lower your credit score substantially.
- **What are the fees charged by debt settlement companies?** Different settlement companies have different fee structures, but there are two basic approaches. In one model, the settlement company's fee will be a percentage of your total debt. The fees under this arrangement typically range from 13-20 percent. For example, if you owe \$30,000 and the settlement company charges you 15 percent of the total debt, then you will pay them \$4,500 in fees.

Another option the settlement company may offer is to base their fee on the amount of debt reduction they can negotiate. Fees under this model can be as high as 35 percent. If the settlement company negotiates your \$30,000 debt down to \$15,000, and charges you a 25 percent fee, you will owe the settlement company \$3,750 in fees.

Additionally, some settlement companies also charge a monthly fee that can range from about \$19 - \$89 a month for the entire program.

- **How soon will the settlement company begin making payments to my creditors?** Some debt settlement companies frontload their fees. In other words, they collect a significant part of their fees before any payment is made to your creditor. If you've stopped paying your creditor and are instead sending money to the settlement company account, that money is likely going to satisfy the settlement company fee before you see any benefit. It can be months after you start the settlement program before your creditor receives any payment.
- **Am I responsible for any part of the forgiven debt?** Once the creditor agrees to accept a settlement, and that agreed upon amount is received by the creditor, they will end efforts to collect the original amount. However, if the amount of the forgiven debt totals \$600 or more, you will generally owe income taxes on the forgiven amount.

Consumers considering using a debt settlement company would be wise to:

- **Review the company's record** with the Better Business Bureau as well as their state Attorney General or Commissioner of Banking.
- **Select a company** that is affiliated with an industry trade association which holds members accountable through accreditation.
- **Confirm that the account** holding your deposits is FDIC-insured.
- **Obtain all disclosures** in writing, including a good faith estimate of costs associated with the settlement.
- **Inquire about refunds** of any money on deposit should you wish to drop out of the program.
- **Be cautious about promises** or guarantees that seem unrealistic.

Consumers who think settlement might be the right answer to their debt situation should be aware that they can work directly with their creditor to arrange a settlement. A recent Consumer Reports article stated, "Chase Card Services spokeswoman Tanya Madison says Chase will negotiate with some debt-settlement companies at a cardholder's request but will not offer more favorable terms than the customer would receive by negotiating directly with the bank. People needing help can find a nonprofit credit counselor through the National Foundation for Credit Counseling (www.debtadvice.org). Those counselors will divide a set monthly payment among creditors to pay off the balance in full over time at reduced interest rates."

The NFCC stands ready to help any consumer struggling to repay debt. Trained and certified counselors can help you evaluate the debt resolution option that is right for you. Your road to financial freedom can start today.



Debt Settlement May be “Too Good to Be True”

NFCC Offers Consumers Tips on Evaluating Debt Settlement Companies

Silver Spring, MD - When the bottom falls out financially, people need help and they need it fast. Being in such a vulnerable situation often makes you susceptible to offers that on the surface may seem good, but in the end leave you worse off than when you began.

The airwaves are filled with ads promising quick relief from debt, and guarantees of happy endings. But all too often, that relief comes at a cost not only to your pocketbook, but to your credit score.

“Debt settlement companies, sometimes known as debt negotiators or arbitrators, can make the path to financial freedom sound appealing,” said Gail Cunningham, spokesperson for the National Foundation for Credit Counseling (NFCC), “but the reality may be very different from the rosy picture painted by the commercials.”

The NFCC encourages consumers to thoroughly investigate and understand any debt settlement or other resolution option before selecting it as a way out of their financial distress, and provides the following information to assist consumers when evaluating debt settlement:

- **Debt settlement** is a process through which your creditor agrees to accept less than the full amount owed, yet considers the balance as paid. Settlement companies often advertise that they can negotiate reductions of 50 percent or more in the debt you owe. They then set up a repayment plan that typically takes between two and four years.
- **Settlement companies charge significant fees.** Different settlement companies have different fee structures, but there are two basic approaches. In one model, the settlement company’s fee will be a percentage of your total debt. The fees in that model typically range from 13-20 percent. Another option the settlement company may offer is to base their fee on the amount of debt reduction they can negotiate. Fees under this model can be as high as 35 percent. In addition, many settlement companies also charge a monthly fee that can range from about \$19 - \$89 a month for the entire program. Either way, it is not uncommon for settlement fees to total thousands of dollars.
- **Some debt settlement companies front load their fees.** In other words, they collect a large part of their fee before you receive any benefit. Much of the money you initially deposit goes to pay the settlement company to satisfy its fees. It can be months after you start the settlement program until your creditor receives any payment.

- **A settlement company may suggest that you stop paying your creditors** and instead begin making deposits into a special third-party account. The settlement company will attempt to negotiate a settlement offer with your creditor once enough money relative to the debt is on deposit. This may take six months or more, although the exact length of time will vary with circumstances. During this time, the balance on your debt can continue to grow if interest and various penalty fees continue to be charged by your creditor. As a result, you may owe more than when you started and your credit may suffer because of your failure to make any payments on your debt. Even worse, legal actions such as wage garnishment or a judgment may be filed against you during this time.
- **Debts paid off through settlement will generally show “Paid by Settlement”** on a consumer’s credit report. If you later apply for new loans or credit, when reviewing your credit report the prospective lender(s) will see that a previous debt was paid by settlement, indicating that your repayment did not cover the total debt that you owed, but that your creditor accepted a lesser amount.
- **The credit score is based on information contained in the credit report**, with the highest consideration given to how you repay your debts. If you’re not repaying the creditor or have missed payments, it will show on your credit report and potentially lower your credit score significantly.
- **The consumer may be responsible for taxes on the forgiven debt.** If the forgiven debt totals \$600 or more, you will generally owe income taxes on the amount forgiven, substantially reducing the total savings from debt settlement.

“The debt settlement industry is largely unregulated,” Cunningham continued, “thus consumers should exercise extreme caution if they decide to work with a settlement company. Many of these companies are very new and inexperienced. During a time when every penny counts, experience does indeed matter.”

The NFCC Member Agencies stand ready to assist consumers with any debt situation. Their trained and certified counselors often have decades of experience dealing with consumers who see no way out of their debt situation. Reach out to the agency nearest you by calling (800) 388-2227, or find an agency online at www.DebtAdvice.org. For assistance in Spanish, dial (800) 682-9832.

- 30 -

The National Foundation for Credit Counseling (NFCC), founded in 1951, is the nation’s largest and longest serving national nonprofit credit counseling organization. The NFCC’s mission is to promote the national agenda for financially responsible behavior and build capacity for its members to deliver the highest quality financial education and counseling services. NFCC members annually help three million consumers through close to 850 community-based offices nationwide. For free and affordable confidential advice through a reputable NFCC member, call 1-800-388-2227, (en Español 1-800-682-9832) or visit www.nfcc.org.