FTC Facts
For Consumers

focus on CREDIT

Federal Trade Commission
For The Consumer

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Knee Deep in 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 some time 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: realistic budgeting, credit counseling from a reputable organization, debt consolidation, or bankruptcy. Debt negotiation is yet another option. 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

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 entertainment, recreation, 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.

Your public library and bookstores have information about budgeting and money management techniques. In addition, 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: The Fair Debt Collection Practices Act is the federal law that dictates how and when a debt collector may contact you. A debt collector may not call you before 8 a.m., after 9 p.m., or while you're at work if the collector knows

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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 asset, and include most credit card debt, bills for medical care, signature loans, and debts for other types of services.

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 cannot 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.

Credit Counseling and Debt Management Plans

Credit Counseling: If you're not disciplined enough to create a workable budget and stick to it, can't work out a repayment plan with your creditors, or can't keep track of mounting bills, consider contacting a credit counseling organization. Many credit counseling organizations are nonprofit and work with you to solve your financial problems. But be aware that, just because an organization says it's "nonprofit," there's no guarantee that its services are free, affordable, or even legitimate. In fact, some credit counseling organizations charge high fees, which may be hidden, or urge consumers to make "voluntary" contributions that can cause more debt.

Most credit counselors offer services through local offices, the Internet, or on the telephone. 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 nonprofit credit counseling programs. Your financial institution, local consumer protection agency, and friends and family also may be good sources of information and referrals.

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 the areas of 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.

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. You should sign up for one of these plans only after 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, which 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 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, and could take 48 months or more to complete. 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.

Protect Yourself

Be wary of credit counseling organizations that:

- charge high up-front or monthly fees for enrolling in credit counseling or a DMP.
- pressure you to make "voluntary contributions," another name for fees.
- won't send you free information about the services they provide without requiring you to provide personal financial information, such as credit card account numbers, and balances.
- try to enroll you in a DMP without spending time reviewing your financial situation.
- offer to enroll you in a DMP without teaching you budgeting and money management skills.
- demand that you make payments into a DMP before your creditors have accepted you into the program.

Debt Consolidation

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. Remember that 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, the costs of consolidation loans can add up. In addition to interest on the loans, 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

Personal bankruptcy generally is considered the debt management option of last resort because the results 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 your filing and the later date of discharge) stay on your credit report for 10 years, and can make it difficult to obtain 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 primary types of personal bankruptcy: Chapter 13 and Chapter 7. Each must be filed in federal bankruptcy court. As of April 2006, the filing fees run about $274 for Chapter 13 and $299 for Chapter 7. Attorney fees are additional and can vary.

Effective October 2005, Congress made sweeping changes to the bankruptcy laws. The net effect of these changes is to give consumers more incentive to seek bankruptcy relief under Chapter 13 rather than Chapter 7. 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 a three-to-five-year period, rather than surrender any property. After you have made all the payments under the plan, you receive a discharge of your debts.

Chapter 7 is known as straight bankruptcy, and involves liquidation of 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 — a trustee — or turned over to your creditors. The new bankruptcy laws have changed the time period during which you can receive a discharge through Chapter 7. You now must wait 8 years after receiving a discharge in Chapter 7 before you can file again under that chapter. The Chapter 13 waiting period is much shorter and can be as little as two years between filings.

Both types of bankruptcy may get rid of unsecured debts and stop foreclosures, repossessions, garnishments and utility shut-offs, and debt collection activities. Both also provide exemptions that allow people to keep certain assets, although exemption amounts vary by state. Note that 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.

Another major change to the bankruptcy laws involves certain hurdles that a consumer must clear before even filing for bankruptcy, no matter what the chapter. 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. That is 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.

Debt Negotiation Programs

Debt negotiation differs greatly from credit counseling and DMPs. It can be very risky, and have a long term negative impact on your credit report and, in turn, your ability to get credit. That's why many states have laws regulating debt negotiation companies and the services they offer. Contact your state Attorney General for more information.

The Claims

Debt negotiation firms may claim they're nonprofit. They also may claim that they can arrange for your unsecured debt — typically credit card debt — to be paid off for anywhere from 10 to 50 percent of the balance owed. For example, if you owe $10,000 on a credit card, a debt negotiation firm may claim it can arrange for you to pay it off with a lesser amount, say $4,000.

The firms often pitch their services as an alternative to bankruptcy. They may claim that using their services will have little or no negative impact on your ability to get credit in the future, or that any negative information can be removed from your credit report when you complete their debt negotiation program. The firms usually tell you to stop making payments to your creditors, and instead, send payments to the debt negotiation company. The firm may promise to hold your funds in a special account and pay your creditors on your behalf.

The Truth

Just because a debt negotiation company describes itself as a "nonprofit" organization, there's no guarantee that the services they offer are legitimate. There also is no guarantee that a creditor will accept partial payment of a legitimate debt. In fact, if you stop making payments on a credit card, late fees and interest usually are added to the debt each month. If you exceed your credit limit, additional fees and charges also can be added. This can cause your original debt to double or triple. What's more, most debt negotiation companies charge consumers substantial fees for their services, including a fee to establish the account with the debt negotiator, a monthly service fee, and a final fee of a percentage of the money you've supposedly saved.

While creditors have no obligation to agree to negotiate the amount a consumer owes, they have a legal obligation to provide accurate information to the credit reporting agencies, including your failure to make monthly payments. That can result in a negative entry on your credit report. And in certain situations, creditors may have the right to sue you to recover the money you owe. In some instances, when creditors win a lawsuit, they have the right to garnish your wages or put a lien on your home. Finally, the Internal Revenue Service may consider any amount of forgiven debt to be taxable income.

Damage Control

Turning to a business that offers help in solving debt problems may seem like a reasonable solution when your bills become unmanageable. But before you do business with any company, check it out with your state Attorney General, local consumer protection agency, and the Better Business Bureau. 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.

Some businesses that offer to help you with your debt problems may charge high fees and fail to follow through on the services they sell. Others may misrepresent the terms of a debt consolidation loan, failing to explain certain costs or mention that you're signing over your home as collateral. Businesses advertising voluntary debt reorganization plans may not explain that the plan is a bankruptcy filing, tell you everything that's involved, or help you through what can be a long and complex process.

In addition, some companies guarantee you a loan if you pay 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 is 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 the consumer will get the loan — or even represent that a loan is likely. Under the federal Telemarketing Sales Rule, a seller or tele-marketer 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've received the loan.

You should be cautious of claims from so-called credit repair clinics. Many companies appeal to consumers with poor credit histories, promising to clean up credit reports for a fee. But you already have the right to have any inaccurate information in your file corrected. And a credit repair clinic cannot have accurate information removed from your credit report, despite their promises. You also should know that federal and some state laws prohibit these companies from charging you for their services until the services are fully performed. Only time and a conscientious effort to repay your debts will improve your credit report.

If you're thinking about getting help to stabilize your financial situation, do some homework first. Find out what services a business provides and what it costs, and don't rely on verbal promises. Get everything in writing, and read your contracts carefully.

For More Information

For more information, see *Fiscal Fitness: Choosing a Credit Counselor*, at ftc.gov/credit.

The FTC works for the consumer 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 to get free information on consumer issues, visit ftc.gov or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. The FTC enters Internet, telemarketing, identity theft, and other fraud-related complaints into Consumer Sentinel, a secure online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

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