

FTC Facts

For Consumers

October 2010



FEDERAL TRADE COMMISSION
FOR THE CONSUMER

ftc.gov ■ 1-877-ftc-help

Settling Your Credit Card Debts

If you've maxed out your credit cards and are getting deeper in debt, chances are you're feeling overwhelmed. How are you ever going to pay down the debt? Now imagine hearing about a company that promises to reduce – or even erase – your debt for pennies on the dollar. Sounds like the answer to your problems, right?

The Federal Trade Commission (FTC), the nation's consumer protection agency, says slow down, and consider how you can get out of the red without spending a whole lot of green.

Debt Settlement Companies

Many different kinds of services claim to help people with debt problems. Among them are "debt settlement" companies that say they'll negotiate with your creditors to reduce the amount you owe. Some debt settlement companies claim that they can arrange for your debt to be paid off for less than the amount you owe – for anywhere from 30 to 70 percent of the balance. For example, if you owe \$10,000 on a credit card, a debt settlement company may claim it can arrange for you to pay off the debt for less, say \$4,000.

But there is no guarantee that debt settlement companies can persuade a credit card company to accept partial payment of a legitimate debt. Even if they can, you must put aside

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money for your creditors each month. Meanwhile, it may be months – or even years – before the debt settlement company negotiates with your credit card company to settle your debts. And, if you stop making your payments in the meantime, the credit card company usually adds late fees and interest to the debt each month. That can cause your original debt to double or triple.

Researching Companies

If you decide to pay a company to negotiate your debt, do some research before you choose one. Consider other people’s experiences with debt settlement companies. One way to do that is to enter the company name with the word “complaints” into an Internet search engine. Read what others have said. You are making a big decision to spend money that could go toward paying down your debt.

Debt Settlement Fees

Companies that sell debt settlement and other debt relief services by phone cannot charge or collect a fee **before** they settle or reduce your debt.

If you do business with a debt settlement company, you may be required to deposit money for the company’s fees and potential settlements in a dedicated bank account, which will be administered by an independent third party called an account administrator. The account administrator may charge you a reasonable fee, and is responsible for transferring funds from your account to pay your creditors and the debt settlement company when settlements occur – as long as:

- the account is at an insured financial institution;
- you own and control the funds (and any interest accrued), and can withdraw them at any time;
- the debt settlement company doesn’t own, control or have any affiliation with the account administrator;

- the debt settlement company doesn’t split fees with the account administrator; and
- you can stop working with the debt settlement company at any time without paying a penalty. If you decide to end the relationship with the company, it must return the money in the account to you within seven business days – minus any fees the company legitimately earned.

Disclosure Requirements

The debt settlement company must give you information about the program before you enroll:

- **Fees and terms.** Before you sign up for the service, the company must explain its fees. If the company charges a specific dollar amount for services, it must tell you what it is. The company can charge you only a portion of its full fee for each debt it settles. For example, say you owe money to five creditors. The company successfully negotiates a settlement with one of your creditors. The company can charge you only a portion of its full fee at this time because it still needs to successfully negotiate with four other creditors. Each time the debt settlement company successfully settles a debt with one of your creditors, the company can charge you another portion of its full fee.
If the company’s fees are based on a percentage of the amount you save through the settlement, it must tell you both the percentage it charges and the estimated dollar

amount that it represents. This may be called a “contingency” fee.

The company also must tell you about any conditions on its services. For example, if it has a refund policy, it must tell you the terms and conditions for getting a refund. If the company has a no-refund policy, it must tell you so before you enroll.

- **Results.** The company must tell you how many months or years it will be before the company will make an offer to each creditor.
- **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.
- **Non-payment.** If the company asks you to stop making payments to your creditors – or if the program relies on you not to make payments – the company must tell you about the possible negative consequences of doing so, including:
 - damage to your credit report and credit score;
 - your creditors may sue you or continue with the collections process; and
 - your credit card companies may charge you additional fees and interest, which will increase the amount you owe.

Tax Consequences

Depending on your financial condition, the money you save by using debt settlement companies can be considered taxable income. Credit card companies and others may report debt settlements to the IRS, and the agency may consider it income, unless it finds you are “insolvent.” You are insolvent when your total debts are more than the fair market value of your total assets. It can be complicated to determine whether someone is insolvent. If you’re not sure whether you qualify for this exception, talk to a tax professional.

RED FLAGS

- Avoid doing business with any company that promises to settle your debt if the company:
- charges any fees before it settles your debts
 - 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
 - tells you it can stop all debt collection calls and lawsuits
 - guarantees that your unsecured debts can be paid off for just pennies on the dollar

Other Options

Working with a debt settlement company is just one option for dealing with your debt. You also could: negotiate directly with your credit card company, work with a credit counselor, or consider bankruptcy.

- **Talk with your credit card company**, even if you have been turned down before. Rather than pay a company to talk to your creditor on your behalf, remember that you can do it yourself for free. You can find the telephone number on your card or your statement. Be persistent. Keep good records of your debts, so that when you do reach the credit card company, you can explain your situation. Your goal is to work out a modified payment plan that reduces your payments to a level you can manage.
If you don't pay on your debt for 180 days, your creditor will write your debt off as a loss; your credit score will take a big hit, and you still will owe the debt. Creditors often are willing to negotiate with you even after they write your debt off as a loss.
- **Contact a credit counselor**. Reputable credit counseling organizations advise people on how to manage money, bills and debts; help them develop budgets; and usually offer free information and workshops. They should discuss your entire financial situation with you, and help you develop a personalized plan to get you out of debt.

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Most credit counselors offer services through local offices, the Internet, or by telephone. Look for an organization that offers in-person, face-to-face counseling. Many universities, military bases, credit unions, housing authorities, and branches of the U.S. Cooperative Extension Service operate nonprofit credit counseling programs. The federal government maintains a list of government-approved organizations, by state, at www.usdoj.gov/ust, the website of the U.S. Trustee Program. That's the organization within the U.S. Department of Justice that supervises bankruptcy cases and trustees. If a credit counseling organization says it's government-approved, check the U.S. Trustee's list of approved organizations to be sure.

- Occasionally, a credit counselor may suggest that you **consider filing for bankruptcy**. Declaring bankruptcy has serious consequences, including lowering your credit score, but credit counselors and other experts say that in some cases, it may make the most sense. Filing for bankruptcy under 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 Chapter 7 bankruptcy process. In Chapter 13, the court approves a repayment plan that allows you to pay off your debts over a three to five year period, without surrendering any property. After you have made all the payments under the plan, your debts are discharged. As part of the Chapter 13 process, you will have to pay a lawyer, and you must get credit counseling from a government-approved organization within six months before you file for any bankruptcy relief.

For More Information

The FTC has free materials about dealing with credit card debt at ftc.gov/credit:

- **Knee Deep in Debt**
- **Fiscal Fitness: Choosing a Credit Counselor**
- **Before You File for Personal Bankruptcy: Information About Credit Counseling and Debtor Education**
- ftc.gov/moneymatters

For more information about dealing with mortgage debt, visit ftc.gov/yourhome.

- **Mortgage Payments Sending You Reeling? Here's What to Do**
- **Foreclosure Rescue Scams: Another Potential Stress for Homeowners in Distress**



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** or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. Watch a new video, *How to File a Complaint*, at **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.

*Federal Trade Commission
Bureau of Consumer Protection
Division of Consumer and Business Education*

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