

## Till Debt Do Us Part

Are you in a long-term relationship with collection agencies -- or worried you're about to be? Which credit-counseling services are sound, and which are scams?

*By Sharlene Johnson*

Chris Johnson, 39, knew she needed help when her credit card debt topped \$15,000. Even working two jobs -- full-time at a university childcare center and part-time at a library -- she couldn't keep up with the minimum payments. Late charges and over-the-limit fees were adding nearly \$400 a month to her debt, and her interest rates had climbed as high as 31 percent. "It became this cycle and I couldn't get out of it," says Johnson, who lives in Fort Collins, Colorado. "The anxiety was horrific."

Johnson racked up the debt after she went back to school to get her degree in human development and family studies eight years ago. Although she also worked two jobs then, the pay was low, so she used credit cards to make ends meet. "I thought if I just worked hard I didn't need to worry about a budget," she says. "It was sloppy thinking combined with desperation that got me in trouble."

In 2006 Johnson made an appointment with Consumer Credit Counseling Service (CCCS) of Northern Colorado and Southeast Wyoming. Counselors there helped her learn how to manage her money. They also set her up with a debt-management plan (DMP), collecting one monthly payment from her and distributing it to her creditors. After she established a record of paying on time, her credit card companies agreed to reduce her interest rates and waive her fees for being late and over the limit. Today she's paid off more than one-third of her total debt and is on track to pay off every penny in less than five years.

Yet for every success story like Johnson's there's a family who got scammed by an unscrupulous company. According to an investigation by the IRS, "many credit-counseling organizations operating as tax-exempt charities are now primarily sellers of debt-reduction plans, motivated by profit, and offering little or no counseling or education." After auditing more than 40 such organizations, the IRS revoked or terminated the tax-exempt status of every last company investigated. Hundreds more, many of them legitimate, have not been audited.

There really is life after debt, as Johnson learned, but you have to be smart to get there. Read this before you sign up with any organization or company that promises to help you reduce your debts or clean up your credit history.

### **Credit Counseling**

**The Claim:** A trained credit counselor will teach you how to budget, manage your money, and map out a reasonable plan for paying off your debt.

**The Truth:** A reputable nonprofit credit-counseling organization, such as the one Johnson used, can help you get back on track financially through education and counseling. For-profit outfits, on the other hand, are probably more interested in selling you services. The Department of Justice's U.S. Trustee Program, which oversees bankruptcy filings, maintains a list of government-approved organizations. To find one in your area, check the list online at [www.usdoj.gov/ust](http://www.usdoj.gov/ust) or contact the bankruptcy clerk in your district.

**The Cost:** Fees vary depending on the extent of services and where you're located; pre-bankruptcy counseling typically costs about \$50. Any fees should be fully disclosed up front and may be based on your income. The nonprofit credit-counseling organizations on the U.S. trustee's list must waive the fee if you are unable to pay.

**Caution:** Be sure to inquire into what type of training counselors receive and if they are accredited or

certified by an outside organization.

### **Debt-Management Plan**

**The Claim:** The plan will help you get on top of your debt by reducing your interest rates and waiving any fees you've accrued. You should be able to pay off your balance in five years or less.

**The Truth:** "A DMP can help you if you have the ability to repay your debt," says Sara Allen Gilbert, executive director of the nonprofit CCCS of Northern Colorado and Southeast Wyoming, "but just can't catch up because of late charges and fees." Instead of paying your credit card companies directly, you make monthly payments to a third party, such as a credit-counseling organization, which then distributes the money among your creditors and negotiates with them on your behalf. After three months of on-time payments, your credit card companies may agree to lower interest rates and waive fees, essentially making your account current again. "These programs don't make sense for everyone," Allen Gilbert cautions. If your debt is too high to pay off within five years -- the standard, industry-wide goal -- or you simply can't afford to make DMP payments, a reputable organization will discuss other options with you, such as consulting with a bankruptcy attorney.

**The Cost:** You'll pay a monthly fee to the organization that administers your DMP. The fee may depend on several factors, such as the laws of the state where you live, the number of creditors who must be paid each month, and your income. At CCCS of Northern Colorado and Southeast Wyoming, for example, the monthly fee is \$6 per creditor, with a maximum of \$50. Low-income clients pay as little as \$10 or \$20 per month.

**Caution:** Once payments begin, monitor your statements closely and stay in touch with your creditors to be sure the program is working as promised. If the organization doesn't make your payments on time, you will fall further behind and your creditors won't waive your fees a second time.

## **Who to Trust?**

### **Debt Consolidation**

**The Claim:** Consolidating all of your debts into one loan, such as a second mortgage or a home equity line of credit, will save you money and simplify your life.

**The Truth:** Depending on your situation, a debt-consolidation loan can be a smart strategy -- or a risky one. On the plus side, interest on a second mortgage or home equity line of credit is usually tax deductible, and the rate may be lower than that which you're currently paying on your credit cards. The downside? "You can lose your home if you can't make the payments," says Chris Long, a fee-only certified financial planner in Chicago. "If you can't pay off your credit cards, your credit will be trashed, but you won't lose your home." For this reason, Long recommends this strategy only for people whose debt was the result of a specific circumstance, such as an illness or a short-term job loss, and who now have the means to pay off the loan.

**The Cost:** When you take out a second mortgage or home equity line of credit, you may have to pay points or other fees. One point equals 1 percent of the loan amount. Ask several lenders for a good-faith estimate and compare their fees and interest rates carefully before you make a decision.

**Caution:** Some lenders may talk up the convenience of making just one monthly payment in an effort to push you into paying off all your debts, including your primary mortgage, with a consolidation loan. But that's not always a good move, particularly if some of your debts are close to being paid off or have a lower interest rate than the new loan.

### **Debt Settlement**

**The Claim:** Debt settlement, sometimes called debt negotiation, will reduce the total amount of your debt by

40 to 60 percent or sometimes more, with no negative impact on your credit report.

**The Truth:** Not to be confused with debt-management plans, debt settlement is a risky proposition, according to the Federal Trade Commission (FTC). These companies don't always contact your creditors as promised. Even if they do, there's no guarantee that a creditor will agree to take less than you owe. Plus, debt settlement may negatively impact your credit report. These companies usually tell you to stop paying your creditors while they negotiate. They may even collect payments from you, promising to pay the creditors on your behalf. "What they don't really explain is that they're going to hold your monthly payments until they have several thousand dollars, and then they're going to use that amount to negotiate with your credit card company," Allen Gilbert says. "Credit card companies do agree sometimes. But you fall severely past due in the process." Even if a settlement is reached, your failure to pay will still show up on your credit report, because creditors are obligated by law to report accurate information to credit bureaus.

**The Cost:** Fees vary but may include an up-front payment plus a percentage of your debt. Debt Resolution Specialists, which was based in Santa Clarita, California, before an FTC investigation shut it down for misleading consumers, charged from 6 to 15 percent of the debt negotiated.

**Caution:** These companies often claim to be nonprofit and say that their services are guaranteed or your money will be refunded. Don't buy it.

### **Credit Repair**

**The Claim:** Your credit report will be cleared of all bankruptcies, late or missed payments, repossessions, and other negative information that harms your credit rating.

**The Truth:** No one can eliminate negative information from your credit report if it's accurate and not due to be removed (usually after seven years or, in the case of a bankruptcy, 10). In the past couple of years the FTC has taken action against at least 20 credit-repair operations that were charging hundreds of dollars in up-front fees for promises they couldn't fulfill. One company, Bad Credit B Gone, claimed that "on average, 80 percent of derogatory information is deleted off your credit report." (That company has since been ordered by the court to stop misleading consumers and to stop charging for services it can't perform.) Many credit-repair operations simply disappear with your money. Others may file a dispute claim for every negative event on your credit report in hopes that some of your creditors may not return the paperwork to the credit bureau to confirm the information. Without that confirmation, the hope is that the credit bureau may be forced to remove the disputed information.

**The Cost:** Scammers often charge hundreds of dollars for this bogus service (Bad Credit B Gone charged \$500 for an individual, \$700 per couple). If your credit report does have errors, you can dispute them yourself at no cost. You can request one free report per year from each of the three credit bureaus (visit [www.annualcreditreport.com](http://www.annualcreditreport.com) or call 877-322-8228). Contact the consumer reporting company to dispute information.

**Caution:** Watch out for "file segregation" scams claiming to give you a new credit identity. The scammers may tell you to apply for an Employer Identification Number from the IRS to use in place of your Social Security number, which is illegal. When it comes to credit repair, says Long, "Save your money."