

Credit Card Management Services, Inc. | Non-Profit Housing & Credit Counseling Organization

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# DEBT MANAGEMENT PLAN vs CREDIT CARD CONSOLIDATION vs DEBT SETTLEMENT

A Guide to Finding the Best Approach to Paying Off Credit Card Debt

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# FACING YOUR CREDIT CARD DEBT

### FACING YOUR CREDIT CARD DEBT

Credit card debt can be overwhelming. Even when we're making the minimum payments, it seems harder and harder to pay down balances. Also, making the minimum payments isn't a solution. Even if you never use a card again, it can still take between 20 and 25 years to pay off a credit card balance when you're only making minimum payments.

It's at times like these that we're most vulnerable to the offers that appear in our mailbox!

"Settle your debt for pennies on the dollar!"

"Refinance your debt and pay one low monthly fee."

"Transfer your balance and pay zero percent interest!"

When dealing with offers like these, what seems too good to be true probably is.

It is possible to pay off credit card debt and there are services that can help you, but it's easy to get confused by all the advertising. Some advertisers will deliberately mix up different terms hoping to grab your attention.

That's why we'd like to provide you with both a breakdown of the three most widely used methods of managing credit card debt and the information you need to make an informed choice about your financial future.

#### **THESE METHODS ARE:**

A DEBT MANAGEMENT PLAN

**CREDIT CARD CONSOLIDATION** 

**DEBT SETTLEMENT** 

# OPTION 1: DEBT MANAGEMENT PLAN

### **OPTION 1: DEBT MANAGEMENT PLAN**

A Debt Management Plan is offered by the financial industry as a means to help consumers who have faced hardship get out of debt.

#### Here's how it works:

#### **STEP 1: DEBT AND CREDIT COUNSELING**

The first step in getting on a Debt Management Plan is a one-on-one debt and credit counseling session with a Certified Credit Counselor. This meeting is usually free and the counselor will help you look through your finances to analyze your spending and saving patterns. This can help you understand how you're accumulating debt and how you can create a balanced household budget.

#### **STEP 2: DEBT MANAGEMENT PLAN**

If you and your counselor agree that it's the right solution, your counselor will contact your creditors and help you establish a Debt Management Plan. Your credit counselor will do this for each of your creditors and determine a single monthly payment.

Most Debt Management Plans take from three to five years to complete. Instead of paying multiple creditors, you simply send your counselor one monthly payment and they ensure that your creditors are paid.

Your cards are cancelled and at the end of the payment period, your debt is paid in full.

## **OPTION 1: DEBT MANAGEMENT PLAN**

#### **STEP 3: BUILD A BETTER FINANCIAL FUTURE**

A Debt Management Plan has a lot of financial benefits. It allows you to:

- Save thousands of dollars in interest.
- ⊘ Lower your monthly payments.
- Ø Lower or eliminate your interest rates.
- Ø Improve your credit rating.
- $\oslash$  Avoid late fees or over-the-limit fees.
- ⊘ Consolidate your monthly payments.
- $\oslash$  Stop collection calls.
- ✓ Avoid bankruptcy.

That doesn't mean it's easy. Once you start a plan, you have to close out your credit cards and learn to live within your means. That's why a Debt Management Plan requires debt and credit counseling before you start. The goal of the counseling session is for you to get control of your finances so that you don't accumulate more debt while paying down your balances.



# DEBT MANAGEMENT PLAN BY THE NUMBERS

## **DEBT MANAGEMENT PLAN – BY THE NUMBERS**

Here's an example of how a Debt Management Plan can work. Let's assume that you're carrying \$10,000 in credit card debt. Here's a breakdown of how you might normally pay off that debt, compared to paying it off with a Debt Management Plan.

	WITHOUT A DEBT MANAGEMENT PLAN	WITH A DEBT MANAGEMENT PLAN
INTEREST RATE	14.9 percent	1.9 percent*
MONTHLY PAYMENT	\$250	\$178
NUMBER OF PAYMENTS	310	60
TOTAL INTEREST PAID	\$9,629	\$490

\*Interest rate deductions are fixed and dependent on the creditor.

You're starting with the same \$10,000 in credit card debt but instead of paying 14.9 percent interest, you could pay as little as 1.9 percent interest. Because your plan is structured, you pay \$178 a month for 60 months and, at the end of that time, you are debt-free. You're also saving over \$9,000 in interest.

#### A Debt Management Plan is designed to help you save and get out of debt responsibly.

# DEBT MANAGEMENT PLAN FREQUENTLY ASKED QUESTIONS

### How does working with a Certified Credit Counselor help me?

A Certified Credit Counselor is there to help you, not the credit card companies. However, a counselor doesn't have any special bargaining power. Their role is to literally provide counsel and help you get control of your personal finances. In order to qualify for a Debt Management Plan, working with a Certified Credit Counselor is a required first step.

#### How are the lower interest rates determined?

The lower interest rates offered by the credit card companies are fixed and don't change, regardless of who is setting up the plan. If a counselor claims that they can cut a special deal with your creditors, be careful. They may not be offering you a legitimate debt management plan.

#### Do I have to cancel my cards?

The goal of a debt management plan is to pay down your debt. Your creditors are extending the lower interest rate because it is understood that you are making an earnest effort to pay your debt to them in full. Canceling your cards is a sign that you understand this and do not plan to incur further debt.

#### Do I have to give up all my credit cards?

You can submit as many of your existing credit cards as you'd like and the more cards you can cancel, the more you'll save in the long term. Ideally if you hold onto a credit card, it should be the one with the lowest balance and interest rate. You should also keep it as an "emergencies only" credit card.

### My credit cards have gone into collections; can you still help me?

Once your debt has gone into collections, a Debt Management Plan is no longer an option. Ideally, you should start a Debt Management Plan before you go into collections. If you've been keeping up with your payments but find that you're starting

### **DEBT MANAGEMENT PLAN – FREQUENTLY ASKED QUESTIONS**

to miss payments due to financial issues, don't wait. The sooner you can get started on a Debt Management Plan, the better for your financial health.

#### What if I can't make the monthly payments?

You and your counselor should discuss a payment schedule and make sure it fits your existing budget. Generally, your monthly payments will be less than what you are currently paying because of the reduction in interest and fees. If you start a payment plan and run into unforeseen circumstances that affect your ability to pay, you should contact your credit counselor. They may be able to recommend an appropriate course of action to keep you on track to make your payments.



# OPTION 2: CREDIT CARD CONSOLIDATION

## **OPTION 2: CREDIT CARD CONSOLIDATION**

If you're having issues with credit cards, you may find yourself receiving offers in the mail for low-interest loans, personal finance loans, or other offers to consolidate your loans.

The theory is this: If you use the loan to pay off your credit cards, you may be able to gain a marginal reduction of your interest rate. You also benefit from only having to make one payment, making it easier to stay on top of your payments.

The problem is, you're still holding the credit cards that got you into debt in the first place. Unless you are able to change your spending and budgeting habits, you're likely to slide further back into debt.

Also, even if you're paying lower interest on the debt, you're still paying interest on the debt.

Make sure that your loan has a low fixed rate. If your rate is variable, you could be subject to higher payments in the future. You should also ask the following questions before you agree to anything:

- ✓ How are the payments structured?
- ✓ Will I be paying a fixed amount every month for a set period of time?
- $\oslash$  Does the loan only require a monthly minimum?

#### THE BEST BAD IDEA – A HOME EQUITY LOAN

The only time that a credit card consolidation loan makes sense is if you're able to get the money by refinancing your mortgage or taking advantage of a home equity line of credit.

The good news is that you can pay off the debt at a fixed rate (depending of the terms of the refinance) over a longer period of time. The bad news is that you're still paying off that debt and it has now been added to your mortgage payment. That is a payment that you cannot afford to miss. Make sure you know what you're getting into before you put your home on the line.

# OPTION 3: DEBT SETTLEMENT

### **OPTION 3: DEBT SETTLEMENT**

Debt settlement tends to be the most predatory option available. Debt settlement agencies are for-profit companies that often use high-pressure sales tactics to attract and keep customers. Debt settlement agencies may claim to be attorney owned but often agencies will have only one lawyer on staff. The rest of their agents are salespeople who are often required to meet strict quotas to earn their pay.

# No matter what initial promises are made, a debt settlement agency:

- Reviews your unsecured accounts to determine a monthly payment.
- $\oslash$  Collects this payment from you every month.
- $\oslash$  Puts the money in escrow and does NOT pay your creditors.
- Allows your accounts to become delinquent and go into collections.
- Negotiates a "payoff" with the collections department for a percentage of what is owed.

#### **A DIRTY SECRET**

There's a dirty secret that debt settlement companies won't tell you; you don't need them. A debt settlement company has no special authority or certification, the only service that they offer is that they're willing to wrangle with your creditors on your behalf.

You could do the same thing yourself and skip the high fees. However, you should be prepared to handle high-pressure collection calls and negotiate with individuals whose job it is to extract as much money from you as possible.

### **OPTION 3: DEBT SETTLEMENT**

After this, your accounts are listed as "settled" on your credit report. This is not a good thing. Your credit score will be negatively impacted for up to seven years, making it difficult to qualify for a mortgage or other bank loan. The IRS also considers more than \$600 of forgiven debt as taxable income. Debt settlement agencies can charge fees up to 40 percent of the total debt that you owe.

In the past, debt settlement was considered a last-chance option before declaring bankruptcy. However, given changes in the financial system, a managed bankruptcy might now be the better option.



# **SIDE-BY-SIDE COMPARISON**

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## **COMPARISON CHART**

To help you make up your mind, we've provided a side-by-side comparison of the three different plan types based on some frequently asked questions.

	DEBT MANAGEMENT	DEBT SETTLEMENT	CREDIT CARD
	PLAN	PLAN	CONSOLIDATION
HOW DOES IT WORK?	The consumer sits down with a Certified Credit Counselor for a Credit and Budget Counseling Session. Based on the situation, a counselor may recommend a Debt Management Plan. The counselor works with creditors to create a structure plan that lowers a consumer's interest rate and allows them to pay off their debt over a fixed period of time. Counselor works with creditors to create a structured plan that lowers a consumer's interest rate and allows them to pay off their debt over a fixed period of time.	The agency recommends that you not pay your credit card bill for a time period of no less than four months. The agency takes the money instead and holds it in an escrow account. Before you go into collections, the agency contacts your credit card company and offers to "settle" your debt using the money you've placed into escrow.	A bank or other organization offers a one-time loan that can be applied to pay off high-interest credit card balances. The consumer is required to pay back the loan over time depending on the terms of the agreement.

	DEBT MANAGEMENT PLAN	DEBT SETTLEMENT PLAN	CREDIT CARD CONSOLIDATION
ARE THERE ANY UPFRONT COSTS?	Initial consultation is free. An agency may charge a nominal monthly service fee regulated by the state in which you live, and based on your financial situation.	Debt settlement agencies can charge fees of up to 25 to 40 percent of your total debt.	Balance transfer fees can equal 3 percent of total balance.
HOW WILL THIS AFFECT MY INTEREST RATES?	Interest rates for credit cards will be lowered to a fixed monthly rate.	Non-payment of monthly minimums may cause creditors to raise your rates. If the agency is unsuccessful in settling your debt, you will need to pay off your balance at these higher rates.	Interest rates can vary depending on loan provider. Interest rates can also increase over time.
HOW WILL IT AFFECT MY CREDIT SCORE?	No short-term effect. In the long term, credit scores will improve.	Credit score can be severely impacted.	No improvement in credit score until debt is paid. If you incur additional debt, your credit score will not improve.

	DEBT MANAGEMENT PLAN	DEBT SETTLEMENT PLAN	CREDIT CARD CONSOLIDATION
HOW LONG WILL IT TAKE TO BE DEBT-FREE?	Payments are structured to last three to five years.	Debts can be settled in less than a year; however, your credit score will be red-flagged for up to seven years.	Depends on the terms of the loan.
WHAT ARE THE HIDDEN COSTS?	None. Debt Management Plans are handled by agencies working on behalf of consumers. Any fees for services must be disclosed and agreed to before signing.	The IRS will assess taxes based on your original debt. That means you will still owe the government after you've settled with your creditors.	Depends on the terms of the loan. Rates can fluctuate over time based on the terms. Late fees can be assessed as well.
WHAT KIND OF TRAINING AND OVERSIGHT ARE INVOLVED?	Certified Credit Counselors have a degree in accounting or finance. They then receive additional training in counseling. Credit Counselors are state certified and are required to meet professional and ethical standards.	Debt Settlement Agencies have little to no government oversight and many U.S. states have attempted to shut them down.	Depends on the issuing agency and the terms of the loan.

# CONCLUSIONS

## CONCLUSIONS

When faced with credit card debt, the best way forward always starts with information. Before you agree to any kind of plan, loan, or settlement, you need to be armed with all the facts. If the counselor or agent you're working with is unable or unwilling to provide that information in an upfront manner, then you should steer clear of them and look for a better option.

Make sure you understand the short and long-term benefits and drawbacks of any program before you sign. Don't be afraid to ask questions and expect thorough answers.

Most important of all, don't let anyone pressure you into a plan that you don't feel comfortable with.

Your financial future may depend on it.



# WANT TO TAKE CONTROL OF YOUR FINANCIAL FUTURE?

DebtHelper.com is a non-profit organization with the goal of helping you get and stay on track financially. Let's see if a Debt Management Plan is right for you.

# **CALL US TODAY AT**

(561)472-8000, or schedule a free credit counseling session.

