

What is a credit counseling agency?

If you're agonizing over debt and finding it hard to keep up with the monthly bills, let alone putting any savings aside, you're not alone. With consumer debt at an all-time high, record numbers of consumers are seeking relief. Short of declaring bankruptcy -- generally considered a last resort -- the best source of help may be a consumer credit counseling agency.

These agencies, which are usually non-profit, provide personalized counseling to consumers who need to pay off unsecured consumer debt, such as credit card and utility bills. Funded chiefly by creditors (typically credit card companies) who hope to recoup some of their money from financially strapped debtors, the solutions that counseling agencies provide may range from education about budgeting fundamentals to negotiating repayment plans with creditors on your behalf, and then managing the agreed-upon payments.

What can a credit counseling agency do for you?

Credit counseling services usually begin with an initial counseling session that is often free of charge. Credit counselors use these sessions to find out as much as they can about your financial circumstances. They look at your basic financial information, including bank accounts, the name and phone number of each creditor, outstanding balances, interest rates, and minimum monthly payments. Along with these, the counselor will also ask you to list your estimated monthly expenses, such as utilities, phone, cable TV/Internet, rent, and child care.

After consulting with you and analyzing your assets, liabilities, and spending habits, the agency will come up with a plan that may include either self-help, counseling assistance, or, more likely, both.

On the self-help side, credit counselors can teach you how to manage your bank accounts and keep accurate records of checks written, ATM and debit card transactions and more, to be sure that your checkbook reflects the correct state of your holdings. A counselor can also help you create a personalized budget that can enable you to get on your feet.

In many cases, the counselor will propose a plan of action that calls for a long-term involvement with the agency. Most likely, if appropriate, the agency will offer to contact each of your unsecured creditors on your behalf to arrange manageable repayment plans through a creditor-approved debt management program (DMP). The counselor may negotiate a lower monthly payment and/or lower interest rate so that more of your payments go towards principal, thus eliminating your debt in less time.

Under a DMP, you will probably be required to close down all of your credit card accounts for the duration of the DMP -- generally 48 months or more. As your focus is on eliminating lingering debt, you must agree not to incur additional consumer debt. You deposit an agreed-upon amount each month with the counseling agency, from which the agency will pay your creditors according to a payment schedule the counselor develops with the creditors. There's usually an initial fee for setting up this account, and the agency will also build its own management fee into your monthly deposit amount.

Which debts can be managed through a debt management program?

It's important to bear in mind that not all of your debts can be managed by a DMP. Most of us carry two types of debts: secured and unsecured. Secured debts are tied to an asset, like your car for a car loan, or your house for a mortgage. Secured creditors have the right to take that asset - repossessing your car or foreclosing on your house - if you stop making payments. Unsecured debts, on the other hand, are not tied to any asset. Examples include credit card debt and debts for services such as medical bills.

DMPs cover only your unsecured debt. If you have secured debts, you must continue to make payments to these creditors directly. If you fall behind with your car payments, work out an agreement with the car loan company or consider selling the car. Pay off the debt to avoid repossession and a negative entry on your credit report. The same goes for your mortgage. If your payments are at risk, contact your lender immediately to avoid foreclosure. Most mortgage lenders will work with you if they believe you're acting in good faith and the situation is temporary.

In addition, be aware that not all unsecured creditors are willing to agree to DMPs or even work with credit counselors. Even if you sign on to a DMP, you will need to deal with this group of unsecured creditors on your own.

What are the benefits of a debt management program?

DMPs can provide the outside control that many overextended consumers may need. The benefits they provide include:

- Convenience: One monthly payment covers multiple creditors, so you don't have to deal with a flurry of bills, or remember which day of the month each bill is due.
- Creditors may bring your accounts current and reduce interest. Some may agree to forego nuisance fees, such as late or over-the-limit fees, while you're enrolled in the program.
- Most creditors will stop their collection activities.
- Having an agreed-upon, well-managed payout plan can reduce stress and family tensions.
- Regular and reduced payments may help you avoid bankruptcy.

Are there any drawbacks to debt management programs?

Whatever benefits may be gained under a DMP should be weighed against some serious drawbacks:

- Creditors are increasingly unwilling to reduce interest rates for consumers in DMPs; some even *increase* their rates (as of this writing, BankOne/First USA, Chase Manhattan, Fleet, and Wells Fargo, among others). For these creditors, you might be better off negotiating payback terms on your own.
- Your credit record may be negatively affected, and the DMP will be a "red flag" on any credit reports that will be seen by potential employers, insurance agencies, landlords, and lenders. While you're in the program, your lender may put a notation on your record indicating that you're in credit counseling. Credit counseling agencies typically don't report information to credit agencies themselves. (Once you complete the program, be sure to contact lenders and tell them to remove such notations).
- Participation in a DMP will have an impact on your ability to obtain a new mortgage or car loan at competitive rates. Some lenders require that applicants be out of a DMP for over a year before they can qualify for financing. In general, you will be charged higher rates to balance out your diminished credit-worthiness. So if you're contemplating a new house or car loan any time within the next 5 years or so, talk to your would-be lenders before signing up for a DMP, to find out their positions on DMP participants.
- By handing over control of payments, you're at the mercy of the agency's errors, oversights, or even abuses. Consider this, for instance: Most credit counseling agencies are funded primarily by credit card companies, which pay the agency a percentage of the money collected for them. Because it's in the agency's best interest to funnel most of your money towards the credit card bills of those lenders, they may give short shrift to your other creditors, and you may find yourself once again a victim of too-late or too-little payments, with resulting penalties.

Is consumer credit counseling right for you?

An estimated 9 million Americans have some contact with a consumer credit counseling agency each year. As a rule of thumb, if your total debt payments, excluding your mortgage and car, exceed 25 percent of your take-home pay, or if you have more than one delinquent account and your monthly minimum required payments on unsecured debt exceed 20 percent of your take-home pay, you should consult a counseling agency right away.

Even if you just feel as though you're in over your head, it still might be a good idea to see whether some of the services offered can help set you on the right track. Consumer credit counseling agencies can be especially helpful if you expect that you may need to delay future payments to creditors. Delayed payments can put your credit rating at risk, thus making it harder to get credit in the future. While no agency can "repair" your credit once it's in trouble (as many scam artists promise!), by working with a credit counselor you may be able to avoid poor payment habits before it's too late. Sometimes even the most basic services, such as budgeting workshops or personalized

budgeting, can make a big difference to your peace of mind and ability to control your financial future. And these services are often free of charge.

But before signing on to a long-term relationship with a credit counseling agency, such as through a DMP, think carefully about whether the services to be provided are things that you can do for yourself. If you're only looking for lower interest rates and monthly payments, and the convenience that a credit counseling agency can provide, then weigh those benefits against the drawbacks noted above.

If, on the other hand, you're overextended and not up to the task of contacting and negotiating with each of your creditors, and then sticking to your own payback plans, then it may well be best for you to hand over the reins to an outside agency with a proven track record in managing those tasks.

How to choose a credit counseling agency

The consumer credit counseling industry is largely unregulated, and rife with "bad apples." Consumer complaints about credit counseling agencies have risen sharply, from 261 a year in 1998, to 1,480 in 2002. The National Consumer Law Center (NCLC) and Consumer Federation of America (CFA) released a report in April 2003, "Credit Counseling in Crisis," detailing problems in the field, such as:

- *Improper advice.* Many agencies automatically funnel clients into DMPs, even if that's not the most appropriate or beneficial plan.
- *Deceptive practices.* Despite the agencies' promises of fail-safe payment systems, creditors are not always paid on time. Another common finding was failure to adequately disclose fees to potential clients (the last thing you need is an unanticipated "hidden fee"!).
- *Abuse of non-profit status:* Nearly every agency has non-profit status, which leads many people to assume that an agency will be low-cost and trustworthy. Don't be fooled into thinking that an agency is not looking for a profit in doing business with you. Some of these agencies are virtual for-profit businesses.

Because of these widespread problems among consumer credit counseling agencies, it's vital that you approach them as a knowledgeable consumer.

Do the research

- Contact the National Foundation for Credit Counseling (NFCC) and the Association of Independent Consumer Credit Counseling Agencies (AICCCA) for a list of agencies affiliated with these trade organizations. By dealing with a member of one of these groups, you'll know that the agency has agreed to be bound by certain fee limits and professional standards.
- Check with the Better Business Bureau (<http://www.bbb.org>), state attorney general, and local consumer protection agency to see if any complaints have been lodged against an agency.

Ask questions

- What services do you offer?
- Do you have educational materials?
- If so, will you send them to me? Are they free?
- Can I access them on the Internet?
- In addition to helping me solve my immediate problem, will you help me develop a plan for avoiding problems in the future?
- What are your fees?
- Do I have to pay anything before you can help me? Are there monthly fees?
- What's the basis for the fees?
- What is the source of your funding?

- Will I have a formal written agreement or contract with you? May I have a copy to review at home? (Always review contracts at home before signing; don't let anyone strong-arm you into signing up on the spot).
- How soon can you take my case?
- Who regulates, oversees, and/or licenses your agency? Is your agency audited?
- Will I work with one counselor or several?
- What are the qualifications of your counselors? Are they accredited or certified? If not, how are they trained?
- Will my personal information (including my address and phone number) be kept confidential?

Ask also about their DMPs:

- How much do I have to owe to participate in a debt management program?
- How do you determine the amount of my payment?
- What happens if this is more than I can afford?
- How does your debt management plan work?
- How will I know my creditors have received payments?
- Is client money put in a separate account from operating funds?
- How often can I get status reports on my accounts?
- Can I get access to my accounts online or by phone?
- Can you get my creditors to lower or eliminate interest and finance charges or waive late fees?
- Is a debt management plan my only option?
- What if I can't maintain the agreed-upon plan?
- What debts will be excluded from the debt management plan?
- Will you help me plan for payment of these debts?
- Who will help me if I have problems with my accounts or creditors?

"Red flags" to look out for

- *High fees.* A typical NFCC agency can charge up to \$75 for setting up a DMP, and from \$10-25 per month as a maintenance fee. AICCCA agencies limit setup charges to \$75 and maintenance fees to \$50 per month. If an agency requires more than \$50 per month as a maintenance fee, that's too high. In particular, if an agency charges 100 percent of the first month's payment as a start-up fee, say a quick goodbye.
- *No fee at all.* Some agencies insist that they ask only for "voluntary contributions." But once you read the fine print, it's clear that these payments aren't voluntary at all. One common tactic is an agency contract that contains a statement like "I voluntarily agree to contribute one month's payment. . . ." If there's no way to opt out of a "contribution," then it's not voluntary.
- *Too nosy, too soon.* The agency should be willing to send you free information about itself and the services it provides without requiring you to provide any details about your situation. If they insist on taking all your information down on the first call, hang up the phone.
- *One size fits all.* Agencies should provide a range of services, including financial and budget counseling and education, as well as DMPs. If they only offer you one choice, a DMP, it's safe to assume that they're a "DMP mill" that can't be counted on to identify the best solution for your particular situation.
- *Aggressive ads that promise the moon.* Get referrals from friends, family, or trade groups such as the NFCC and AICCCA. Don't respond to TV and Internet advertising that will promise you anything; chances are, the agencies that promise the most, deliver the least.
- *Debt consolidation loans.* Some agencies make a strong pitch for these types of loans, by which you borrow money to pay off all of your outstanding debt, and then pay off the new loan, often over an extended period of time and sometimes at a lower interest rate. What the agency probably won't tell you is that for most people, these loans can be disastrous.

For one thing, the long-term interest cost of the new loan can be far more than it would otherwise cost to pay off your current debt. But even worse is the fact that in most cases, a debt consolidation loan is really a second mortgage, with your home as collateral. So in taking out a debt consolidation loan to pay off all your credit card debt, you're actually exchanging an unsecured debt for one that's secured. The difference becomes crucial if worse comes to worst and you need to file for bankruptcy. In a bankruptcy, unsecured debt can often be discharged. In the case of secured debts, however, the creditor often has the right to seize the collateral if the loan cannot be repaid. Thus, you're literally "betting the house" on your ability to repay the loan. Be wary of a counselor who advises this without filling you in on the consequences.